THE VOTING TRUST

A Device for Corporate Control

BY JOHN ANTON LEAVITT

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J. A. L.

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— I —

THE NATURE AND IMPORTANCE OF VOTING TRUSTS

ONE OF THE simplest methods of placing the control of a corporation in the hands of a given group of men is through the use of a voting trust. This device has been defined as "an agreement which accumulates in the hands of a person or persons shares of several owners, in trust, for the purpose of voting them, in order, through the selection and election of directors, to control the corporate business and affairs." [1] Elsewhere, "A voting trust may be defined as a transfer of the legal title and voting power of shares of stock of a corporation to a trustee or trustees for a limited period for the purpose of concentrating control of such corporation in the hands of fewer persons than the whole number of its shareholders." [2] In these definitions is found, among other things, the one essential of a voting trust: the transfer of stock to trustees who will for a period thereafter exercise the voting rights of owners.

The trust agreement, recorded in a written contract, provides that the assenting stockholders shall deposit their stock with the voting trustees in exchange for voting trust certificates for a like number of shares. On the termination of the agreement, at some specified or determinable time in the future, the certificate holders are entitled to the return of their stock on the surrender of the certificates; but during

[1] *Ruling Case Law,* Permanent Supplement, III, 1986.

[2] Burke, "Voting Trusts Currently Observed," *Minnesota Law Review,* XXIV (1940), 347 footnote.

its continuance the trustees may vote the stock as they see fit, provided, however, that the agreement does not restrict their power in this respect. Usually the certificate holders have a right to all dividends received by the trustees, but since title to the stock has been transferred to the trustees any restrictions on the use of the stock, or the use of the dividends, by the trustees, must be specified in the agreement. The parties to the contract must include the depositing stockholders and the trustees; while the corporation, a trust company (acting as agent for the trustees), and the reorganization managers may be included.[3]

On occasion the trustees may hold the stock of more than one corporation (most definitions of a voting trust ignore this fact); this, however, makes for no fundamental change in the nature of the device. In this connection it is well to point out that the Standard Oil Trust was of this type, but, because of its monopolistic purpose, and because its trustees were periodically elected by the certificate holders, we will not concern ourselves with it. In a sense this trust (like similar ones of the same period) was a voting trust, but a discussion of it would take us too far afield.[4] Other trusts involving more than one stock issue are, however, germane to our study.

The best approximation, for our purpose, to a satisfactory classification of the uses of voting trusts is in accordance with the phase in the corporation's "life cycle" at which the trust

[3] William Fletcher (*Cyclopedia of the Law of Private Corporations*, V, 264) gives the following definition: "A voting trust may be comprehensively defined as one created by an agreement between a group of the stockholders of a corporation and the trustee, or by a group of identical agreements between individual stockholders and a common trustee, whereby it is provided that for a term of years, or for a period contingent upon a certain event, or until the agreement is terminated, control over the stock owned by such stockholders, either for certain purposes or for all, shall be lodged in the trustee, either with or without a reservation to the owners or persons designated by them of the power to direct how such control shall be used."

[4] The details of the formation of early American monopolies have been presented so abundantly that it would serve no useful purpose to duplicate this material. Before the turn of the century, as is well known, the word "trust" became associated with monopolistic combinations, but it is not in this sense that it is used here.

was created. On this basis trusts may be divided into four groups: (1) those created at the inception of new corporations; (2) those set up by the managers of mature and successful corporations; (3) those established under the pressure of public officials; and (4) those resulting from the reorganization of bankrupt or financially weak companies. For the present we shall confine our attention to how and why the first and last of these types are used, postponing until later consideration of the other two.

Corporate reorganization is the most important occasion for the use of a voting trust—if importance may be estimated from a numerical standpoint. One of the avowed purposes of a trust created at such a time is to give a measure of control over a corporation to those persons who provide the money for the reorganization, or to those persons who have the largest financial interest in a "sick" corporation. As to those in the first group, it often happens that the bankers who provide the new money required for the reorganization demand and often get control of the corporation through their appointment as voting trustees. This procedure has been justified by the fact that the bankers need some assurance that the reorganized firm will be managed in such a manner as not to find itself in difficulties again. As to the interests of the second group, those who have the largest stake in the enterprise, we may assume that no new money is needed in the reorganization, but that some convenient method is necessary to adjust the conflicting interests of the creditors and the stockholders. If the proposed reorganization is to be voluntary the stockholders may be willing to forego their legal rights to control the corporation in order to avoid a judicial sale of the property, which might entirely eliminate them from the picture. On the other hand the creditors prefer to avoid the expenses of foreclosure and may be willing to permit the stockholders to benefit from a future improvement in the business provided they are given control over the company for a period of years.

In the event of an involuntary reorganization the creditors may be willing to deal more leniently with the stockholders if they are given control. In either case a voting trust may be used to transfer the control of a corporation from the stockholders to the creditors.

A second group of trusts originate with the genesis of new corporations. Some of these are old businesses which have only been reincorporated, while others are entirely new firms. The incorporators of a company may desire to keep control in their hands even though they are not willing to provide the necessary capital to do so. Their problem is solved by creating a voting trust which permits them to control the corporation and yet sell its stock in the form of trust certificates. Under different circumstances the incorporators of a close corporation may desire to distribute the voting power in proportions other than those indicated by the distribution of the stock itself. Obviously the voting trust is a simple way of doing this.

This study began by pointing out that the voting trust is a device to fix the control of a corporation in the hands of a given group of men. Expanding this concept, it is found that the purpose of every voting trust is to perpetuate an existing corporate control or to transfer and then fix the control. If the voting trust results from a corporate reorganization, control may first be taken from the stockholders and then placed for a period of time with the creditors or their representatives; while other trusts may only have the effect of strengthening a control which might, without this protection, be overthrown. In either event, however, it is this element of "control" which constitutes the purpose of every voting trust.

A consequence, and, in a sense, one of the purposes of almost every voting trust is the concentration of the control of a corporation in the hands of far fewer men than would otherwise be the case. Instead of a system in which each stockholder is entitled to one vote for each share of stock owned

there is substituted a corporate dictatorship. Each stockholder surrenders his voting right to the same small group of men with the hope that the corporation will be better managed. It is not the purpose of this section to comment on the benefits or the evils of this system, but only to emphasize one of the fundamental characteristics of the voting trust. This fact is implicit in the writings of students of the subject, including those who are favorably inclined toward voting trusts, although very few of them have developed the thought in any detail. Thus it is believed that "The coincident increase in the complexity of corporate problems and in the number of stockholders has rendered it important to devise mechanisms for the centralization of corporate control." [5] But regardless of what one's opinions may be as to the good or bad effects of concentration of corporate control in general, the fact remains that the voting trust does lead to precisely this situation.

A second effect of the use of a trust is the separation of ownership and control.[6] Legally, the stockholders are the owners of the stock in the corporation and as a consequence are entitled to control its operation. But by the use of a voting trust, they are disenfranchised; i. e., ownership and control are separated. In the event that factual control did not rest with the stockholders prior to the creation of a voting trust and that actual control did not shift as a result of the introduction of the trust, then it was legal (or potential) control only which was separated from ownership. In any event, however, whenever control, real or legal, is taken from the stockholders their rights are materially weakened.[7]

Some examples will illustrate various concrete situations which are likely to occur.

[5] "Voting Trusts: Their Nature and Validity," *Harvard Law Review*, XL (1926–27), 106.

[6] This may be also the dominant motive for the use of this device.

[7] Conceivably ownership and control might not be separated by a voting trust if its purpose was only to adjust the relative rights of the several stockholders of a close corporation.

First, assuming that a voting trust is created for a new co: poration and that trust certificates are sold in place of stocl ownership and control are completely separated for the dur tion of the trust. Control which would otherwise have reste with the stockholders has been transferred to the trustees.

Second, let us assume that the "management control" of previously organized corporation decides to create a trust t protect its existing position. Here factual control is nc changed as the result of the trust, but a future change ma have been prevented, which amounts to about the same thin In any event, the beneficial stockholders, and the legal owner have been estopped from any future intervention in the cor trol of the corporation so long as the voting trust continue in force.

In the third case a trust is employed for a voluntarily re organized corporation. The stockholders, having little equit in the corporation, will gladly give up their control in orde not to be eliminated. Control, it is said, is thus given to th creditors who, from a practical point of view, own the coi poration anyway. Superficially, control and practical owne ship, but not legal ownership, have been joined by the dis enfranchisement of the stockholders, but this line of reason ing has one weakness—in all probability the creditors do no assume direct command of the company. It is the agents o the creditors, usually bankers, who are made trustees. Th creditors probably cannot even control the selection of th trustees, let alone their actions after appointment. Thoug one cannot say that practical ownership and control hav been separated by the trust, neither can it be said that the have been united; control has merely changed hands. Quit possibly the corporation will be managed for the benefit o the creditors, but control and ownership are neverthele separated.

To repeat: one of the most important characteristics o practically every voting trust is the separation of ownershi

from the control over property. All of the other methods of control, to be discussed presently, have the same effect, but none does it so effectively or completely as the voting trust.

As a consequence of this separation a new problem arises. No longer can it be assumed that the corporation will be managed for the profit of the beneficial stockholders because it is necessarily in the interest of the control to do so. The control, meaning the trustees, may have no direct financial interest in the corporation. If they own no stock in the corporation, their income cannot come from dividends but must come from some other source. This source may be the salary paid to them by the corporation; the prestige salvaged by the banker (previously a seller of the corporation's bonds) who rescues a bankrupt corporation; or, finally, the trustees' income may be derived from the mismanagement of the corporation for their own personal advantage. If the trustees have proper motives and are capable, the corporation may prosper; indeed, perhaps more so than if the stockholders directly controlled the business. But a voting trust does not necessarily insure good management. Time and again writers insist that the purpose of a trust is to insure good management; such may be the purpose of a trust, but good management does not necessarily follow its creation. All that a trust can do is to insure the continuance of either good or bad management by the centralization of control in the hands of a few men.

There are five major ways in which a man or a group of men may control a corporation.[8] "These include (1) control through almost complete ownership, (2) majority control, (3) control through a legal device without majority ownership, (4) minority control, and (5) management control."[9] Since the main purpose of this section is to compare the methods by which ownership and control are separated, and

[8] See A. A. Berle, Jr., and Gardiner C. Means, *The Modern Corporation and Private Property*, chap. V.
[9] *Ibid.*, p. 70.

control is concentrated into a few hands, a discussion of the first two types is not warranted, but the three remaining deserve, however, at least brief consideration.

The holding company is a legal arrangement whereby several corporations may be bound together into a system composed of several layers of corporations—each layer (which may consist of one corporation or of many) owning at least a majority of the voting stock of the preceding layer. The companies at the bottom of the pyramid are the operating companies whose real economic services provide the income for the entire system; while at the top sits the parent holding company which controls the entire system with but a fraction of the investment which the operating companies represent.

A second legal device centralizing control and separating it from ownership is found in the issue of nonvoting stock. The legal owners of the property are disenfranchised by a direct and obvious method. The control of the corporation is placed in the hands of those men who hold the small issue of voting stock, stock which may have been received as reimbursement for the organization of the corporation.

"Minority control" involves a limited investment in the stock of a corporation in conjunction with the ability to command proxies for additional stock sufficient to control a company. "Management control," on the other hand, requires little or no investment in the corporation on the part of those in control. It depends solely on the dispersion of stock ownership and the ability of the control to secure proxies. In neither case is the voting right of the stockholder restricted, but he is merely willing to delegate his right either because of his small investment or because of the inconvenience of voting.

In comparing the three above methods to that of the third legal device—the voting trust—it can be seen that of all the methods of control this is, perhaps, the simplest, the most secure, and, unlike two of the others, requires no investment.

First, "pyramiding," since it involves the use of several corporations, is cumbersome and increases the tax load. And in addition, some investment, even if small, is required by the control. On the other hand, voting trust control may be exercised without any investment, and its use does not significantly [10] increase the amount of taxes to be paid. However, assuming that a holding company system is conservatively capitalized, "pyramiding" permits greater permanency of control.

Second, the issuance of nonvoting common stock facilitates the control of a corporation by a small investment, or sometimes by none at all. The device is simple and permanent, but there is one serious objection to its use: it has been subjected to considerable criticism in recent years, and neither the New York Stock Exchange or the New York Curb Exchange permit the listing of new issues of nonvoting common stock.[11] This, it is believed, will effectively restrict its use by large corporations.

Third, "minority control" and "management control" lack the fixity or security of the control exercised under a voting trust. Each year, in order to stay in power those in control of the corporation must actively solicit and obtain the requisite number of proxies. Even though control under either method can, and often does, continue uninterrupted over a period of years, the management must always reckon with the possibility that a proxy fight may develop at any time. The relative positions of the several men in control may not be well defined, so that disputes may develop; while by contrast, the control exercised under a voting trust is fixed, at least for a period of years, and the relative positions of those in control are defined by a written agreement.

The one ostensible weakness of the voting trust lies in the

[10] Stock transfer taxes have to be paid at the beginning and at the termination of the trust, and the issuance of voting trust certificates might conceivably be taxed. But, at most, the charge would not be very great.

[11] Berle and Means, *The Modern Corporation*, p. 76.

fact that its duration is usually limited either by statutory or common law. Were it not for this fact it is probable that it would have been used far more than has been the case. Nevertheless, trusts may be extended from time to time, and by the use of devices to force the deposit of stock with the trustees, they develop a character of permanency. This possibility is well supported by the abundance of examples.

In view of the obvious advantages of the voting trust as a means of concentrating control out of all proportion to investment, it is surprising that it has not been used more often. One possible explanation of this fact is found in the following quotation:

> Control through a voting trust differs from other forms of legal control, and from the forms of factual control . . . in that it is fixed, defined, and inalienable, with certain definite and well recognized responsibilities attached. Under the other arrangements so far discussed, control may be bought or sold; may pass by inheritance in case of death; its location may not be generally known (in fact, it frequently is not) and its holder has never stood up in public and assumed the definite obligations of its possession. Control through a voting trust is open, not easily transferred, and therefore responsible. Presumably, it is this open acceptance of responsibility which has reduced the criticism of the voting trust, making it an effective device for maintaining control without ownership. Perhaps for the same reason it has not been extensively employed in the larger corporations, since those individuals desiring to control a company may not wish to assume the responsibilities and liabilities which a trust would impose upon them.[12]

Quite possibly some potential trustees may object to accepting the responsibility entailed by a voting trust, but a more likely reason for its restricted use is found in its history. Until the nineteen twenties, the voting trust was traditionally associated with corporate reorganizations so that it came to be thought of as a device only to be used under such circumstances. During the twenties, however, it came to

[12] *Ibid.*, p. 78.

be used more and more as an instrument of control, so that had not the trend been checked by the depression, it seems probable that the voting trust would have been developed still further. Nevertheless, as events have turned out, the device has reverted, at least for the time being, to its former position.

Legally, the relationship between the corporation and the trustees is simple; the corporation views them as stockholders, and theoretically at least, need not concern itself with the fact that they are not the beneficial owners of the stock held in their name. In short, the trust exists apart from the corporation, even though in all probability the same men are both directors and trustees. As trustees they elect themselves directors, and as directors they compensate themselves as trustees. Thus the distinction between them is legal, not practical. Nevertheless, for the sake of completeness, it should be mentioned that a trust might be created and maintained without the knowledge of the management of the corporation, although this is, admittedly, most unlikely.

Three further facts may elucidate the relationship of the corporation to the trust: the corporation may be a party to the trust agreement; the company's certificate of incorporation may permit, or provide for, the creation of a trust; and a trust may be a part of the corporation's plan of reorganization.

If the corporation is to be bound by the trust agreement it is necessary that it be a party to it; for otherwise, it cannot be forced to pay the expenses of the trust, compensate the trustees, or pay dividends directly to the certificate holders rather than the trustees. However, an independent promise on the part of the corporation to pay for the "benefits" of the trust may serve the purpose equally well.[18] Far more important than this, an individual stockholder may contest the

[18] Fletcher, *Cyclopedia of the Law of Private Corporations*, V, 325.

payment of compensation to the trustees more easily if the corporation is not a party to the contract.[14] In any event, it is legally prudent, though not always the case, for the corporation to join.

A second tie between the trust and the corporation is sometimes found in the company's certificate of incorporation. Thus the Sperry Corporation has the right to "purchase, hold, sell, transfer, re-issue or cancel the shares of its own capital stock or voting trust certificates representing interests therein or any other securities." [15]

An excellent example of a certificate of incorporation which permits the formation of a trust, and at the same time attempts to protect the trust from attack, is found in the following: "The holders of all or any part of the shares of the capital stock of the corporation shall have the right from time to time at their discretion to create and form a voting trust or voting trusts. Any such voting trust so formed, if otherwise legal, shall not be held to be void or against public policy because of any separation of the ownership or voting power of such stock from the beneficial interest therein. The mutual agreements of the parties to any such voting trust shall alone be deemed a sufficient consideration to uphold and validate such voting trust. . . . The Corporation may cause its stock or any portion thereof to be originally issued to and in the name of voting trustees . . . and may itself become a party to any such voting trust agreement and agree to pay all expenses connected therewith." [16] The obvious purpose of this provision is to insure the legality of any trust that might be created

[14] See *Clark* v. *National Steel & Wire Co.*, 82 Conn. 178, 72 Atl. 930 (1909). In any event, however, the payment of the expenses of a trust by a corporation might be questioned. In *Sagalyn* v. *Meekins, Packard & Wheat, Inc.* (290 Mass. 434, 195 N.E. 769, 1935) a stockholder sued the directors to recover for the corporation the funds expended in setting up a trust. The directors had created the trust to insure their continued control despite dissension among the stockholders. The Court held that the amount of the expenses should be refunded to the corporation.

[15] Sperry Corporation, Certificate of Incorporation (1933), p. 4.

[16] Starrett Corporation, Certificate of Incorporation (1936), Sec. 17.

(and one was), and the right of the corporation to become a party to the agreement. Although this provision was probably not necessary, it was prudent, to say the least, for trusts have been invalidated by the courts on the basis of considerations which may be inferred from the above.

The certificate of incorporation of the Consumers' Gâs Trust of 1887 outlined the provisions of and provided for a trust agreement. All of the corporation's stock was initially issued to trustees. This case may, however, be an exception, as no recent examples have been found.[17]

Quite commonly the reorganization plan of a corporation will sketch the major provisions of a proposed trust agreement. Usually the plan mentions the stock to be included in the trust; the duration of the trust; how the trustees are to be selected in the first place and later; and how the trust is to be terminated. The space ordinarily devoted to the trust is little more than that required to tell about it, and a good share is given to the provision relating to the selection of trustees. For example, the reorganization plan of the Missouri Pacific Railroad Company, approved January 10, 1940, by the Interstate Commerce Commission, provided that the five trustees should be chosen in the following manner: three to be designated by the protective committee for the Missouri Pacific First and Refunding Mortgage Bonds; one by the committee for the New Orleans, Texas, and Mexico First Mortgage Bonds; and one by the Committee for the International-Great Northern First Mortgage Bonds.

Of the different methods available for indicating the importance of voting trusts, two are sufficient for our purpose: a list of the important companies which have or have had trusts; and an estimate of the percentage of corporations having trusts.

The following corporations had trusts during the years indicated:

[17] See Cushing, *Voting Trusts*, pp. 75–76, for a discussion of this trust.

American Water Works and Electric Company	1914–1924 and 1931–1933
Atchison, Topeka and Santa Fe Railroad Company	1889–1895
Baltimore and Ohio Railroad Company	1899–1901
Chesapeake and Ohio Railway Company	1889–1894
Cliffs Corporation	1929–1939
Crown Zellerbach Corporation	1928–1938
Erie Railroad Company (has had several other trusts)	1895–1904
General Theatres Equipment, Incorporated	1929–1939
Interborough Rapid Transit Company	1922–1937
International-Great Northern Railroad Company	1922–1924
Missouri Pacific Railroad Company	1917–1922
Southern Railway Company (two different trusts)	1894–to present.
St. Louis and San Francisco Railway Company	1896–1901
United Stores Corporation	1929–1939
Utilities Power and Light Corporation	1925–1935
Virginian Railway Company	1919–1935

While all but one of these trusts have expired, the immediate future will probably see the addition of several, such as that of the Missouri Pacific Railroad.

Next, in order to find out the percentage of companies which simultaneously have had trusts at different times in the past, it is desirable to approximate the figure by several different methods to be used as checks against one another. Thus it is found that at least nine of the two hundred largest corporations in 1931 had voting trusts, i. e., almost five percent.[18] On the other hand, in 1930 only about two-thirds of one percent of the several thousand corporations listed in the *National Monthly Stock Summary* for that year had trusts.[19] Of the eight hundred and forty-six companies having stock listed on the New York Stock Exchange at the beginning of

[18] The two hundred corporations are taken from Berle and Means, *The Modern Corporation*, pp. 97–98.

[19] This figure was computed by the simple method of counting the companies with trusts and dividing by the estimated number of corporations covered.

1930 twenty-seven, or three and two-tenths percent, had voting trusts,[20] while at the same time the New York Curb Exchange listed sixteen companies with trust certificates out of four hundred and seventy-five, or three and one-third percent.[21]

Ten years later, in January, 1940, a little over one percent of the corporations listed in the *National Monthly Stock Summary* had voting trusts. Of these, however, seventy-six percent were real estate companies reorganized during the thirties; while during the earlier period (c. 1930) practically no firms of this type were included. In January, 1940, out of the eight hundred and fifty-four companies whose stock was listed on the New York Stock Exchange, nine had voting trusts; [22] while of the four hundred and one listed on the New York Curb Exchange, six had voting trusts.[23]

Bringing all the above data together for comparison, we get the following:

[20] The following companies had trust certificates listed on the New York Stock Exchange, January 2, 1930; American Commercial Alcohol Corp.; American Seating Co.; American Writing Paper Corp.; Armour & Co. (Ill.); Chicago, Milwaukee, St. Paul & Pacific Railroad Co.; Columbian Carbon Co.; Cream of Wheat Corp.; Crown Zellerbach Corp.; General Outdoor Advertising Co., Inc.; Gold Dust Corp.; Graham-Paige Motors Corp.; The Grand Union Co.; Howe Sound Corp.; Indian Refining Co.; Interborough Rapid Transit Co.; International Railways of Central America; Madison Square Garden Corp.; National Distillers Products Corp.; Omnibus Corp.; Servel, Inc.; United Carbon Co.; United Electric Coal Co.; United States Leather Co.; Virginia-Carolina Chemical Corp.; Wesson Oil & Snowdrift, Inc.; Western Dairy Products Co.; and the White Rock Mineral Spring Co.

[21] The following companies had trust certificates listed on the New York Curb Exchange, December 31, 1929; Air Investors, Inc.; Airstocks, Inc.; Albert Pick, Barth & Co., Inc.; The Angus Company; Bellanca Aircraft Corp.; Cable Radio Tube Corp.; Central Atlantic States Service Corp.; Consolidated Automatic Merchandising Corp.; Consolidated Theatres, Ltd.; Curtiss Airports Corp.; General Industrial Alcohol Corp.; General Theatres Equipment, Inc.; Grocery Store Products, Inc.; S. Oppenheimer & Co.; Transcontinental Air Transport, Inc.; and the United Retail Chemists Corp.

[22] Pennsylvania Glass Sand Corp.; Baldwin Locomotive Works; Houston Oil Co. of Texas; Columbia Pictures Corp.; Columbia Carbon Co.; Consolidation Coal Co.; L. C. Smith & Corona Typewriters, Inc.; Sperry Corp.; United Merchants & Manufacturers.

[23] Cable Electric Products, Inc.; Ludwig Baumann & Co.; Electrol, Inc.; Rio Grande Valley Gas Co.; Starrett Corp.; Universal Corp.

		Percent with trusts 1930		Percent with trusts 1940
Two hundred largest corporations		4.50		...
National Monthly Stock Summary		.66		1.00
New York Stock Exchange	(27 ÷ 846)	3.19	(9 ÷ 854)	1.05
New York Curb Exchange	(16 ÷ 475)	3.37	(6 ÷ 401)	1.49

Two things are evident: the larger corporations are more likely to have voting trusts; and in a sense, the device was less important in 1930 than in 1940. With respect to the first point, the *National Monthly Stock Summary* lists the securities of relatively small companies in which there is some public interest; the stock exchanges, on the whole, trade in the securities of larger companies; thus, at least in 1930, the voting trust was most frequently used by the country's largest corporations. An exception to this general statement, however, must be recognized: the voting trust has, since 1930, been used extensively by small real estate companies (the capitalization of which seldom exceeds $10,000,000). Were it not for this fact, only about one-quarter of one percent of the companies listed in the *National Monthly Stock Summary* for 1940 would have had voting trusts.

With respect to the changing importance of voting trusts, the question of real estate companies again arises. Both stock exchanges had fewer trust certificates listed in 1940 than in 1930, but the numerous small real estate trusts increased the figure for the *National Monthly Stock Summary*.

In sum, then, it may be said that: the number of voting trusts has recently increased; the importance of this increase is qualified by the fact that most of the newer trusts are found among the small, unlisted real estate companies; and with the exception of this recent and possibly sporadic development, the voting trust has been more frequently used by the larger companies.

— II —

THE HISTORY AND EARLY USE OF VOTING TRUSTS

THE VOTING TRUST came relatively late in the development of the business corporation. Previous to the Civil War the corporate form was used only for certain types of enterprises; namely, banks, canal companies, gas and water companies, ferries, toll roads, bridges, large cotton mills, and, toward the end of the period, railroads.[1] But even though some of these corporations were of moderate size, the first known voting trust was not established until 1864. Because, for the following thirty or forty years the device was used mainly in connection with the railroads which were expanding rapidly during the period,[2] most writers have associated its origin with this development.

H. A. Cushing, in his monograph on *Voting Trusts*, gives the impression that the origin of trusts is to be found in the early railroad reorganizations.

> If a bank ceased to be solvent, holding only the usual assets of such concerns and with no plant or real estate investment to be gradually developed, the natural result was a prompt winding up of the business, without any attempt at reorganization. When, on the other hand, the rapid expansion of railroads under ill-considered financial policies led to or threatened disaster, there existed the road itself which could not be abandoned and the saving of which required the concerted action of either the former owners or new investors or of both. . . . Naturally thus the history of corporate

[1] A. S. Dewing, *The Financial Policy of Corporations* (3d ed.), 1934, p. 8.
[2] E. L. Bogart, *Economic History of the American People*, p. 634.

development in the last fifty years has been marked by the introduction and refinement of the reorganization agreement or readjustment agreement. Usually as an incident or as a result of these . . . there gradually was developed the voting trust agreement.[3]

Though it is true, as will be seen later, that practically all of the early trusts were used by railroads, it is not true that any big majority of the trusts were associated with corporate reorganizations.

VOTING TRUSTS: 1864–1880

The first trust of which there is any record, that of the Pacific Mail Steamship Company created in 1864, did not result from a reorganization. The agreement provided that for four years none of the stockholders should sell his holdings, without first offering them to the other stockholders or to the trustees. Although an irrevocable power of attorney to vote the stock was given to the trustees, in the place of issuing trust certificates, the agreement was, in effect, a voting trust.[4] Only four years later a trust was created for the Atlantic and Great Western Railroad, but the trustees held only a part of the outstanding stock.[5]

In 1872, the owners of the common stock of the St. Louis, Kansas City, and Northern Railway agreed to place their stock with four trustees for the purpose of enabling the trustees to enforce the provisions of a contract (relating to the interchange of traffic) among this company, the Pennsylvania Company, the Chicago, Alton and St. Louis Company and the Kansas Pacific Railway Company. The trust was perpetual, but in 1879 the road was consolidated with another line, and it may be assumed that the trust was eliminated. A trust for a similar purpose was created in 1880 for the stock of the Atlantic and Pacific Railroad Company. The

[3] Cushing, *Voting Trusts*, pp. 1–2.

[4] See *Brown* v. *Pacific M.S.S. Co.*, 5 Blatchford 524, for litigation involving the trust. The trust was upheld by the court.

[5] See Cushing, *Voting Trusts*, p. 8.

St. Louis and San Francisco Railway and the Atchison, Topeka and Santa Fe Railroad desired to control this company jointly, so that a voting trust was established to insure this result. The agreement was not to terminate for thirty years, but prior to this, in 1897, the Atlantic and Pacific was sold at a foreclosure sale and parts of it were bought by the two other roads. Similarly, the New York, Lake Erie and Western Railroad (the Erie) used the voting trust to gain control of the Chicago and Atlantic Railway and the Cincinnati, Hamilton and Dayton Railroad. The stock of these two companies was deposited with the president of the Erie so that all three roads could be operated as one system. In this connection it should be mentioned that the Erie has had a number of trusts, including those resulting from its reorganizations in 1877 and in 1895.[6]

Most of the voting trusts mentioned above did not result from reorganizations, but during this period there was at least an equal number that did. Of these, the most interesting was the case of the Mobile and Ohio Railroad following 1876. A majority of the stockholders (those who assented to the plan of reorganization) were given trust certificates and the stock was deposited with the Farmers' Loan and Trust Company as trustee. The debenture holders got one vote for each one hundred dollars of principal amount of the debentures held by them, so that they might instruct the trust company as to how it should vote the stock. The trust was to terminate on the maturity and payment of the debentures in 1927, but an issue of fifty-year mortgage bonds in 1888 had the effect of increasing the trust's life at least until 1938, or until the redemption of the bonds. In 1901 the Southern Railway acquired control of the Mobile and Ohio, first by trading its stock for the stock of the Mobile and later by the issuance of "perpetual stock trust certificates." Thereafter, the voting trust of the Mobile held the trust certificates, but not the

[6] See *ibid.*, pp. 8–9, for a discussion of the various Erie trusts.

stock, of the Southern, thus eliminating the voting rights of the debenture holders for all practical purposes. Since the Southern guaranteed a four percent dividend to the stockholders of the Mobile, the certificate holders actually were the owners of the equivalent of collateral trust bonds.[7]

There appears to be no reason for the continuance of this trust after 1901 as there has been nothing for the trustees to do. For a number of years they have acted only as an intermediary in collecting dividends on the Southern certificates and paying them out to the holders of the Mobile and Ohio. Had the trust been terminated, the dividends would have been paid directly to the ultimate recipients, thus avoiding one transfer. Nevertheless, the trust was still in existence in January, 1940, but it is doubtful whether it will survive the reorganizations of the two roads.[8] It is of interest to note that a majority of the bonds of the Mobile, the payment of which would terminate the trust, have been owned by the Southern for a number of years. Everything considered, some explanation on the part of the trustees and the Southern appears to be necessary in order to justify the continuance of the trust.[9]

The voting trust of the New York, Pennsylvania, and Ohio Railroad (previously the Atlantic and Great Western, mentioned above) was created in 1880 by English bankers for the protection of English bondholders. Of the five trustees three were to be chosen by the first mortgage bondholders and the remaining two by the other classes of bondholders. The trust was to terminate when the third mortgage bondholders received seven percent interest for three consecutive years. In 1896 the railroad was reorganized, thus ending its second voting trust. Under a similar trust created for the St.

[7] The Mobile stock was placed in a trust as security for the payment of the dividends by the Southern.

[8] The bonds were not redeemed in 1938.

[9] According to Moody's 1939 Railroad Manual a suit has been filed to force the dissolution of the trust and to determine why the bonds have not been retired.

Louis, Iron Mountain and Southern in 1875, Baring Brothers and Company was made trustee.[10]

RAILROAD REORGANIZATIONS: 1880–1927

Though, as we have seen, a number of trusts had been created by 1880,[11] it was not until the late eighties and during the decade of the nineties that the device was widely used. During this period there were numerous railroad reorganizations, many of which made use of the voting trust. Presumably with these facts in mind, practically all writers have recognized these years as the ones during which the device became popular,[12] but no one has mentioned the fact that the trust owes its popularity apparently to J. P. Morgan and Company. During this period Mr. Morgan was a trustee for the following railroads: the Philadelphia and Reading (1886); Chesapeake and Ohio (1888); Southern Railway (1894); Erie (1895); Northern Pacific (1896); and the Reading Company (1896). Morgan and Company was equally involved in the later railroad and early industrial reorganizations which resulted in voting trusts.[13]

One of the most interesting trusts, that of the Atchison, Topeka and Santa Fe Railroad in 1889 and 1890, was part of a voluntary reorganization which was intended to rehabilitate the road, but only resulted in a second reorganization five years later. Under the agreement of 1889 George

[10] Cushing, *Voting Trusts*, p. 4.

[11] A trust was established as a part of the reorganization plan of the New York, Ontario and Western Railway in 1880, and terminated in 1905.

[12] "A few voting trusts were established in connection with the railroad reorganizations following the panic of 1873, but they came into general use only with the reorganizations of the middle nineties." (Dewing, *Financial Policy of Corporations*, p. 387).

[13] J. P. Morgan, or members of the partnership, was trustee for the following companies: Harper and Brothers (1900); International Mercantile Marine (1902); Cincinnati, Hamilton and Dayton; Cramp and Sons Shipbuilding Company; International Harvester Company (1910); International Agricultural Corporation; Guaranty Trust Company of New York; Bankers Trust Company of New York (1903). The companies for which no dates were to be found, were mentioned during the Money Trust Investigation of 1913.

Magoun, Thomas Baring, Oliver Peabody, and John McCook were the voting trustees; if vacancies occurred, they were to be filled by the remaining trustees with the assent of Kidder, Peabody and Company. The trust was to remain in force for ten years. In a letter to the stockholders to encourage the deposit of stock, Kidder Peabody pointed out that it was desirable to retain in control the management which came into power as a result of the reorganization. This control could be purchased, they said, for only $13,000,000 at the prevailing market price for the stock. To avoid the possibility of the road falling into the hands of some competing or connecting railroad, which would not use the property for the benefit of the minority stockholders, it was suggested that a voting trust be formed. As the agreement stated: "The danger is one which we have thought serious enough to induce us to undertake this unwelcome position of responsibility." The stockholders, however, apparently were not convinced, so that a new trust, more advantageous from the standpoint of the stockholders, was created a year later to supersede the old one. Three more men were added to the first four as voting trustees; the trust was to terminate in five years; and the assent of Kidder, Peabody and Company was no longer necessary to fill vacancies among the trustees. A second letter to the stockholders in 1890 mentions these changes, and as a further inducement said that the trust certificates were to be listed on the New York Stock Exchange. Since the trust was not to be effective until a majority of the shares were deposited, and since the certificates were never listed on the exchange, it may be that the trust was technically never in existence. But this is of no great interest for our purpose, as the same management was still in power until 1894.

During the five-year period between 1889 and 1894 the management did little to bear out their own previous assertion that it would be a tragedy if others got control of the corporation. A report to the reorganization committee in 1894

showed that the income of the railroad for the previous four years had been overstated by the management to the extent of several million dollars. One means by which the accounts were falsified was to show, as an available asset, $3,700,000, which had been paid out as rebates to shippers. This amount was charged to an account called "Auditors Suspended Account—Special," whatever that may mean.[14] It is of interest to note that the Atchison reorganization plan of 1895 states that "A voting trust has been considered, but has been rejected as unsatisfactory."

On the reorganization of the Southern Railway Company in 1894, J. P. Morgan, Charles Lanier, and George F. Baker were made trustees. The agreement provided that the trust should end in five years if a five percent dividend had been paid in one year on the preferred stock; otherwise, the trust was to continue until such dividend had been paid. After a part of the dividend necessary to terminate the trust had already been paid, the trustees sent (August 27, 1902) a letter to the certificate holders asking for an extension. It was pointed out that unless the trust was renewed "The certificates for the actual Preferred and Common Stock of the Company would thus be issued and dealt in in the market, making it possible for the control of the company to be bought and sold from day to day and rendering its policies and management subject to sudden and surprising change." Thus an extension was desired by the "Holders of large amounts of Preferred and Common Stock Voting Trust Certificates." Large holders had suggested that the Board of Directors postpone until September the determination of whether or not the October dividend should be paid, "for it might well be that while a dividend at a certain rate could be conservatively paid under a continuance of the existing administration, the Board might feel hesitation in declaring so large a dividend if stability in

[14] See the Stephen Little *Report on the Overstatement of Income of the Atchison and the St. Louis and San Francisco Systems, Respectively, for the Four Years Ended June 30, 1894.*

the control and management of the Company should be endangered by the termination of the Voting Trust. . . . Accordingly the Board has postponed fixing the rate of the dividend."

The obvious implication of this letter was that, if the trust was not extended, the dividend necessary to terminate the trust would not be paid. As a result, the stockholders assented to an extension of the trust until 1907 or thereafter, until a majority of the owners of the assented stock, or the trustees, should terminate it. It so happened that not until 1914, twenty years after its formation, did George Baker and Charles Lanier, the surviving trustees, find that the condition of the company was such that the voting trust might be terminated.

Different from the preceding trusts are several which have apparently had a most uneventful existence. For example, a trust agreement for the Chesapeake and Ohio Railway, dated January, 1889, naming J. P. Morgan, John Crosby Brown, and George Bliss as trustees, terminated five years later at the appointed time. Likewise, the trust of the St. Louis and San Francisco Railway (1896) ended in five years. On occasion, however, trusts have been terminated before the prescribed time, as in the case of the Baltimore and Ohio Railroad trust (1899) which was ended two and one-half years early (1901).

Although there is no need at this point to discuss the later railroad reorganizations it is well to remember that this use of the device was equally frequent after the turn of the century. A. S. Dewing goes so far as to say that since the middle nineties "very nearly every railway reorganization of importance, and most public utility and industrial reorganizations have enjoyed the voting trust for at least a short period." [15] Although this appears to involve some exaggeration there have, nevertheless, been a number of such cases, including the Chicago, Great Western Railroad (1909–1914),

[15] Dewing, *Financial Policy of Corporations*, p. 388.

Chicago Railways Company (1908–1912), The Denver and Salt Lake Railway (1927–1937), International–Great Northern Railroad (1922–1924), Midland Valley Railroad (1913–1923), and the Missouri Pacific Railroad (1917–1922). In addition to these there are also the trusts arising from the present reorganizations.

INDUSTRIAL AND PUBLIC UTILITY REORGANIZATIONS

Prior to 1900, voting trusts appear to have been seldom used in connection with the reorganization of industrial and public utility corporations. Moody's 1900 *Manual of Industrial and Miscellaneous Securities* mentions only two such trusts—those of Appleton and Company and Harper and Brothers—for the eighteen hundred companies covered. The Appleton trust was to terminate on the payment of its three year notes, while the Harper trust was to end in five years. In the public utility field, however, four years earlier the reorganization plan of the Brooklyn Rapid Transit Company (later the B.M.T.) established a trust. In 1902, shortly after the creation of the combination launched by the Morgan firm, the ill-fated International Mercantile Marine Company was reorganized with a trust. J. P. Morgan, Charles Steele, J. Bruce Ismay, P. A. B. Widener, and Lord Pirrie were the trustees under a five-year agreement. Nevertheless, the trust did not end until 1915, as it was twice extended.

The General Motors Corporation, organized in 1908, was reorganized two years later with a voting trust which was to terminate in five years or on the redemption of all the six percent first lien, five-year sinking-fund notes. The trust was dissolved by the redemption of the notes in 1915.

A most interesting trust is that of the Houston Oil Company of Texas created on the voluntary "readjustment" of the company in 1912 for the purpose of eliminating accumulated preferred dividends. Though the trust has been amended on several occasions, it still retains the provision that it shall

terminate either on the redemption of the preferred stock (an event which need never take place) or fifteen years after the death of the last surviving voting trustee. Nevertheless, the trust is not onerous in its terms, as the trust certificate holders have the right to remove any trustee, if they desire, and may demand a proxy in order to vote the stock in which they have a beneficial interest. From the standpoint of the management the advantage of the trust lies in the fact that the trustees are always able to vote all of the stock for which proxies have not been demanded. In January, 1940, the trust completed its twenty-eighth year of existence.

Following the World War a number of trusts were created in connection with corporate reorganizations. The Goodyear Tire and Rubber Company formed a trust in 1921 which ended, before its prescribed time, in 1927. The Brooklyn-Manhattan Transit Corporation acquired its second trust in 1923. Though it had a potential existence of thirty years, it ended in 1928. Other trusts of some interest include the Columbia Phonograph Company (1923–1925), Gorham Manufacturing Company (1924–1939), Interborough Rapid Transit Company (1922–1937); Kansas City Public Service Company (1926–1936), Moline Plow Company (1922–1925), Republic Motor Truck Company (1924–1929), and the Wickwire Spencer Steel Company (1925–1931).

EARLY USE OF TRUSTS FOR OTHER PURPOSES

The first voting trust created for an entirely new corporation, of which there is any record, was that of the Wisconsin Central Company, incorporated in 1887. The company was formed to combine several railroads by means of stock purchases, so that in addition to its other distinguishing features it was one of the first holding companies.[16] Title to the stocks

[16] "Although the holding corporation had existed since 1892, and even occasionally under Pennsylvania statutes as early as 1870, the fact remains that only since 1905 or thereabouts has its use become general" (Dewing, *Financial Policy of Corporations*, p. 9).

and bonds of some eight hundred miles of railroads, purchased by the company, was vested in three voting trustees in exchange for nonvoting trust certificates. The only restriction placed upon the trustees under this perpetual agreement was in the filling of vacancies: the certificate holders had the right to approve the nomination of succeeding trustees made by the surviving trustees. This corporation, furthermore, was one of the first to have its voting trust certificates listed on the New York Stock Exchange (in May, 1889). As an investment, however, it did not fare very well, for ten years later the corporation was reorganized as an operating company, by the exchange of securities, with a new five-year voting trust.

The voting trust of the Bankers Trust Company of New York, organized and controlled by J. P. Morgan and others, was created in 1903 without the aid of any public offering of voting trust certificates. Although it was to terminate in five years, it was twice extended (1908 and 1912), and, according to H. A. Cushing,[17] did not finally end until sometime before 1914. This trust and that of the Guaranty Trust Company of New York were discussed a number of times before the Pujo Committee.[18] In neither case was their existence generally known, and it seems that this fact aroused the most criticism. In this connection it is well to mention that the Committee found no "evidence of the existence of such voting trusts in national banks."[19] Nevertheless, it was recommended that voting trusts for national banks be prohibited.

Other voting trusts have been created, not for entirely new companies, but on the incorporation, or the reincorporation, of an existing concern. In 1911 the International Nickel Company established a trust which was superseded the following year by an almost identical agreement when the company was

[17] *Voting Trusts*, p. 27. The present writer could find no information on the termination of this trust.

[18] *Money Trust Investigation*, 1913, Report of the Committee, p. 142.

[19] *Ibid.*

consolidated with the Colonial Nickel Company. A large majority of both the preferred and the common stock was deposited under an agreement to continue for five years. At the same time the trust certificates were listed on the New York Stock Exchange.

Although a trust was formed on the reincorporation of the Loose-Wiles Biscuit Company, its predecessor was in no financial difficulty. Established in 1912, the trust did not end until 1927 after having been twice extended. The new preferred stock of the company, not included in the trust, was sold by William Solomon and Company, one of whose partners, in return, was made a voting trustee for the common stock. In this case also, the trust certificates were listed on the New York Stock Exchange though there was no direct public offering of the certificates.

In 1902 and in the following years, the St. Louis and San Francisco Railway used several voting trusts as a means of acquiring control of other railroads. The Frisco entered into two trust agreements in this year with the Colonial Trust Company, one of which applied to the common stock and the other to the preferred stock of the Chicago and Eastern Illinois Railroad. At the end of forty years, on the termination of the agreement, the preferred stockholders were to receive one hundred and fifty dollars per share and the common stockholders two hundred and fifty dollars. For the duration of the trust the common stock was guaranteed dividends of ten dollars a year and the preferred six dollars by the Frisco. Frisco trust certificates were issued against this stock. Here again, as in the case of the Mobile and Ohio, the certificates were in reality collateral trust bonds; but the security for the payment of the "bonds" was the stock of the Chicago Railroad, so that when the Frisco defaulted on the interest payments in 1913 the certificate holders eventually (1916) got their stock back. The Chicago road was reorganized separately, thus eliminating the combination.

An interesting example of an attempt to use the trust as a means of combining several railroads is found in a syndicate formed by E. R. Bacon in 1890 to control the stock of the Baltimore and Ohio. The plan was to join a network of lines reaching from the "Atlantic to the Pacific, and from New York to Mississippi," [20] under the control of one trustee for a period of three years. But whatever may have been the practical result of this trust, it had been dissolved by 1899 when the Baltimore and Ohio was reorganized.

A trust was formed for the stock of the Virginian Railway in 1919 at a time when the line was in no financial difficulty. The only apparent purpose was to strengthen the control of the late H. H. Rogers, who was the largest stockholder.[21] The public was not asked to invest in trust certificates, nor was the existence of the trust generally known.[22] In 1935, a short time before the stock was sold to the Koppers Coal Company interests, which had been negotiating for its purchase for several years, the trust was terminated by the trustees.[23]

In the preceding part of this chapter we have outlined the history and the early use of voting trusts, mainly, by the use of specific example; in the following sections the problem will be approached statistically. Because of the fact that a disproportionately large part of the examples of this early period involved railroads the statistical method was not used sooner. The table covers most of the trusts included in this study re-

[20] Stuart Daggett, *Railroad Reorganization*, p. 18.

[21] Over 90 percent of the preferred and common stock of the railway was held by the estate and family of the late H. H. Rogers. (U.S. Senate, Subcommittee on Interstate Commerce, 75th Cong., 1st Sess. Investigation of Railroads, Holding Companies and Affiliated Companies. Hearings pursuant to S. Res. 71, Part 10, p. 4189.)

[22] Berle and Means, in *The Modern Corporation*, make no mention of this trust though they discuss the railroad in connection with the various types of control; Poor's manuals and also Moody's make only occasional reference to it. A copy of the agreement is obtainable at the Columbia University Library.

[23] U.S. Senate, Subcommittee on Interstate Commerce. Investigation of Railroads, Holding Companies and Affiliated Companies, Hearings pursuant to S. Res. 71, Part 10, p. 4190.

gardless of the time at which they were created; examination of the table will prove fruitful.

VOTING TRUSTS: 1864–1923

Out of the sixty-five voting trusts created from 1864 through 1923, thirty-nine, or over one-half, were the result of corporate reorganizations; of these, seventeen were railroads, in good part reorganized before 1900, and twenty-two industrials and public utilities in which the voting trust was formed after 1900. Only eight of the sixty-five trusts were associated with new companies and most of these were created late in the period; all involved industrials and holding companies. Included in the miscellaneous group of eighteen trusts

CORPORATIONS USING VOTING TRUSTS *

DATE OF CREATION	CIRCUMSTANCE UNDER WHICH TRUST WAS CREATED						TOTAL
	Reorganization of firm		*Incorporation of company*		*Other*		
1864–1923 inclusive	railroads	17	industrials	6	railroads	10	
	industrials	17	holding	2	industrials	6	
	utilities	5	railroads	0	utility	1	
	holding	0	utilities	0	holding	1	
		39		8		18	65
1924–1930	industrials	9	holding	16	industrials	8	
	utilities	2	industrials	5	utilities	4	
	railroad	1	utilities	2	holding	1	
	holding	1	railroads	0	railroads	0	
		13		23		13	49
1931–1939	industrials	10	holding	1	holding	1	
	holding	5	industrials	0	industrials	2	
	utilities	4	utilities	0	utilities	0	
	railroads	0	railroads	0	railroads	0	
		19		1		4	24
Total		71		32		35	138

* Among the industrials only the small fraction of real estate companies for which trust agreements were available are represented here. Had all the two-hundred or more been included about which information was secured the table would have been greatly overweighted with small companies.

are all those which do not conveniently fall into the other classes; included are all trusts created after the incorporation of a company and before reorganization resulting from financial difficulty. About one-half of these trusts involved railroad combinations, as did several of the industrial trusts.

VOTING TRUSTS: 1924–1930

It will be noticed in the table that more trusts were created in the second period than in the third. This fact, however, has no significance, as real estate trusts are in the main excluded, for reasons which have been explained.[24] The book capital of the companies to which the trusts relate varied from less than a million dollars to several hundred millions, but the larger the corporation the more likely its inclusion in our study. Nevertheless, keeping in mind the partial exclusion of real estate companies, the trusts included in the last two periods should constitute a fairly representative sample of all those created from 1924 to 1940.

It is apparent from the table that beginning in 1924 (or even a little before) the voting trust was used to a lesser extent for corporate reorganizations. While over one-half were so used during the first period, less than one-third resulted from reorganizations during the twenties. Instead, the device was used in connection with the launching of new companies. During the first period, only about one-eighth of the trusts were so used, as compared with almost one-half in the 1924–1930 period.[25]

One of the things that so clearly distinguishes this period from its predecessor is the sale of voting trust certificates to the general public by new corporations—an act almost unknown before 1920. Instead of being used to "protect" the creditors of a reorganized corporation, the device was openly

[24] See footnote, p. 32.

[25] Three of the eight trusts associated with promotions in the first period were created after the end of 1919. Nevertheless, the difference between the fractions is not increased by rearranging the periods.

used to protect the control of the promoters after they had disposed of their investment. In regard to the voting trust, as well as other phases of corporate practice, the twenties saw a relaxing of standards. A second point of interest is that the type of company using trusts changed in this decade. In the first period railroads made frequent use of the device both in reorganizations and for miscellaneous purposes, while in the second period only one small railroad (The Denver and Salt Lake Railway) formed a trust.[26] These years witnessed the development of the industrial and, especially, the holding company trust. All told, almost one-third of the voting trusts in the twenties related to holding companies as compared to one-twentieth during the earlier period.

By way of summary, two developments of the twenties separate the period from its predecessor: first, the use of the trust in promotions; and second, the rise of the holding company trust. In other words, the trust was little used in reorganizations, and the use of the device by railroads almost disappeared.

VOTING TRUSTS: 1931–1940

The depression of the thirties brought a new change which, in part, reversed the trend of the twenties. Once again the important use of the voting trust was in connection with corporate reorganizations,[27] and only one trust was established for a new company.[28] As has already been mentioned, no railroad trusts are included in the table because most of the large railroads are currently in the process of reorganization.

The most significant development of the last ten years is

[26] The fact that this was a prosperous period with few reorganizations no doubt accounts for this development.

[27] Arthur S. Dewing, writing in 1934 (*Financial Policy of Corporations*, p. 394), states that "The most common use of the voting trust at the present time is to insure for the new corporation, just promoted and having no time to give evidence of its inherent earning power, the continuation of the management given to it by its promoters and bankers at its inception."

[28] The Universal Corporation (1936–1946). This company owns the stock of the Universal Pictures Corporation.

the use of the voting trust in the field of real estate reorganizations. In terms of numbers, and perhaps even as measured by the value of the property controlled, this is now the most important use of the device. According to the report of a House committee investigating real estate reorganizations, companies selling almost $20,000,000,000 worth of securities during the twenties have been reorganized during the thirties, for the most part, with voting trusts.[29] Assuming that each corporation is capitalized at $2,711,000 [30] this would indicate that several thousand real estate trusts are now in existence. Ostensibly, the sample study of the Securities and Exchange Commission in finding that "of the 136 [real estate] reorganization plans analyzed, 71 per cent . . . contained provisions for voting trusts," substantiates this conclusion.[31] But like the House investigation, the commission spent most of its time examining the few large "chain protective committees" which were more likely to create trusts than those reorganizing a single property. A more conservative—and reasonable—estimate of the importance of real estate trusts places their number as somewhere between one and two thousand, and the amount of property in their control as in excess of a billion dollars.

This use of voting trusts by small companies is surprising because the need is not apparent. One would think, in view of the small number of stockholders, that control was sufficiently fixed and concentrated without the aid of a trust. As will be seen later, the facts do not speak well for this use of the device.

We have seen that the voting trust was first used in connection with the railroad consolidations and reorganizations

[29] Supplemental Report of a committee of the U.S. House of Representatives, Committee on Investigation of Real Estate Bondholders' Reorganizations. 74th Cong., 2nd Sess., Supplementary Report, pp. 2, 24.

[30] This is the average for those examined, which includes, however, a disproportionate number of large corporations.

[31] Securities and Exchange Commission, *Report on . . . Protective and Reorganization Committees,* Part III, p. 198.

between the end of the Civil War and 1880; but not until the late eighties and nineties was it popularized by the railroad reorganizations of the period. Following 1900 trusts were commonly used in public utility and industrial reorganizations, and at times, under other circumstances; while after 1923 they were used more commonly in corporate promotions. With the coming of the depression, however, new companies ceased to be formed, so that once again the trust came to be associated mainly with corporate reorganizations.

— III —

THE VOTING TRUST AGREEMENT

EARLY VOTING TRUST agreements contained little more than a provision for the transfer of the stock of a corporation to trustees and an agreement on the part of the trustees to distribute the dividends received by them to the certificate holders.[1] At the present time the typical agreement is from ten to as much as thirty pages in length and contains provisions covering all probable and some improbable contingencies. In this chapter we shall examine, in effect, a trust agreement compounded from numerous trusts: no one agreement is likely to contain all of the provisions discussed here, but the reader should gain a reasonably good idea of what such agreements usually cover. The significant provisions are presented from the viewpoint of the economists, rather than that of the lawyer.

THE CONTRACTING PARTIES

The parties to the trust agreement must include the depositing stockholders and the trustees, although later depositors may join without signing the agreement. At times, only the trustees actually sign the agreement since it may be provided that a depositor assents to the contract by the deposit of his stock with the trustees.

Among the participants to the trust agreement of the Gorham Manufacturing Company (1924–1939) [2] were the stock-

[1] Cushing, *Voting Trusts*, p. 2.

[2] The dates following the name of a company always refer to the beginning and the actual termination of its trust.

holders, the trustees, and a trust company. The contracting parties in the case of the American Writing Paper Company (1928–1933) were the reorganization committee, the voting trustees, the stockholders, and the new corporation which was formed. The trust agreement of the Starrett Corporation (1936–) was signed by the trustees, the stockholders, and the corporation: that of the Sperry Corporation (1933–) by the stockholders, the trustees, the corporation, and by a trust company. As a final example, the company, the reorganization managers, the trustees, and the common and preferred stockholders were the parties to the agreement in the case of the Consolidation Coal Company (1935–).[3] Mr. Cushing's statement that the company is rarely a party to the agreement[4] may have been true in the past, but would be difficult to substantiate at the present time. The corporation is now commonly one of the signatories to it.

NUMBER OF TRUSTEES

Although in a large majority of the trusts there are either three or five trustees—three is the favorite number by at least two to one—there may be anywhere from one to nine or more. On the reorganization of Electrol Incorporated (1936–) one man was made trustee—the president of the company. Surprisingly enough, some agreements provide for an even number of trustees. Thus the Kentucky Ohio Gas Company (1933–) had two trustees; the Central Hudson Gas and Electric Corporation (1927–1937) four; and the Gold Dust Corporation (1924–1938) six. This is difficult to understand since disputes may arise in which the opinion is evenly divided. The Creameries of America, Incorporated (1930–) started with only two trustees, later, on the consolidation of the corporation with another company, the trustees having the right to choose three more, one trustee was added. Similarly, the trust agreement for the Worthington

[3] For further examples see Cushing, *Voting Trusts*, p. 119. [4] *Ibid.*, p. 120.

Pump and Machinery Corporation (1916–1921) made provision for an increase in the number of trustees. The Continental Steel Corporation trust (1927–1932), created on the merger of this firm with several others, had nine trustees. It will be noted from these examples that, when the trust is formed as part of a consolidation plan, the number of trustees tends to be larger.

STOCK INCLUDED IN THE TRUST

As a rule it may be said that both the preferred and the common stock are included in the voting trust provided that both issues have voting rights. In the Sulzberger and Sons Company trust (1915–1920), however, the preferred stock was included even though it had no voting right until the dividends had not been paid for a year. On the other hand the trust to be created by the proposed reorganization plan of the Missouri Pacific Railroad includes only the preferred stock although the common stock also has one vote per share.

PURPOSE OF THE TRUST

On the first page of practically every trust agreement there is found some statement of the reason for the creation of the trust. Ordinarily, this statement of purpose is either meaningless or misleading. A common statement is that "The stockholders deem it for the best interests of themselves and of the Corporation to act together concerning the management of the Corporation." [5] The trust for the Atchison, Topeka and Santa Fe (1889) was created for the purpose (among other things) of protecting the "interests [of stockholders] and enhancing the value of the shares." Its trust was set up a year later to insure a "prudent and economical management." An excellent example of an agreement in which occurs a misleading (or false) statement of purpose is that of the Cincinnati, Hamilton and Dayton Railroad. Here we are told that

[5] Creameries of America, Inc., trust agreement, p. 1.

"Whereas it is deemed important to the interest of the stockholders of the Cincinnati . . . Railroad to create a trust with a share-holding body as beneficiaries thereof, in order that the stock of said company shall not be liable to be bought up for speculative control, and to secure safe and prudent management . . . , and likewise to guard against the consolidation of the stock of said company with another company, or a sale or lease of its road with another company, or a sale or lease of its road . . . without due consideration on the part of the stockholders, the undersigned stockholders . . . have agreed as follows: . . ." As a matter of fact, the purpose of the trust was to place control of the road with the New York, Lake Erie and Western Railroad.[6] Often it is difficult to tell from reading the trust agreement whether the trust resulted from a corporate reorganization or not. In any event it is impossible to learn the specific object of a voting trust by reading the agreement.

TRUST CERTIFICATES

On the deposit of stock with the trustees (or their agent) the trustees agree to issue a voting trust certificate or certificates for an equivalent number of shares to the depositor. The form of the certificate is almost without exception included in the trust agreement, but the trustees commonly reserve the right to make minor changes in its wording. The certificate subject to the trust agreement usually includes the following provisions:

(1) on a specified, or otherwise determinable, future date the certificate holder is entitled to the return of his stock;
(2) during the continuance of the trust the certificate holder is entitled to receive payments equal to the cash dividends received by the trustees;
(3) until the return of the stock the trustees shall possess all of the rights and powers of absolute owners (with possibly certain specified exceptions);

[6] See *Hafer* v. *N.Y., L.E. and W.*, 14 Weekly Law Bull. 68.

(4) the certificate is issued pursuant to, and subject to the conditions of the trust agreement; and
(5) the certificates are transferable at the office of the agent for the trustees in accordance with the rules which the trustees may establish.

The provisions of the trust certificate are often repeated in the body of the trust agreement, and, as will be seen, some of them are there developed in more detail. As a rule, the certificate contains only the essence of the trust agreement.

RETURN OF STOCK

Most of the present agreements make some provision for the return and the voting of the stock after the termination of the trust. Such provisions are desirable in view of the fact that it may be a number of years before all the certificates have been canceled. (As will be seen later, trust certificates are regularly bought and sold in the market for long periods after the termination of the trust.)

First; with respect to the voting of the stock after the end of the agreement, it is often provided that trustees may continue to vote the stock registered in their name "so long as they shall be or shall continue to be record holders of such shares of stock or other securities." [7] This often has the effect of extending the effective life of a trust several years, since many certificate holders will not demand a return of their stock.

A more complicated set of provisions has been devised for the purpose of relieving trustees or their agents of responsibility after the end of the trust. The agreement of the Consolidation Coal Company (1935–) reads [8] that "After the expiration of sixty days from the termination of the trust of this agreement . . . the Trustees . . . shall be entitled

[7] American Water Works and Electric Company trust agreement, p. 20. See also the trust agreements of The International Nickel Company (p. 4), and of the Gold Dust Corporation (paragraph six).

[8] Page 17. Unless otherwise indicated the page numbers given in this chapter relate to voting trust agreements.

to file in any Court of competent jurisdiction proceedings to have such Court assume jurisdiction over the care and distribution of any shares of stock, monies or other property then held by said Trustees or their Agents hereunder and shall be entitled to deposit the same in the registry of the Court. . . . The Expenses of said proceedings may be charged to the holders of the then outstanding voting trust certificates entitled to the distribution of such shares or other property." No doubt the fact that this trust was the result of a reorganization accounts, in part, for the method by which the matter was handled.

The agreement of the Universal Corporation contains [9] the following provision: the "Voting Trustees may [not "must"] deposit with said The Chase National Bank . . . certificates expressed to represent such stock duly indorsed in blank, . . . as may be called for by the outstanding voting trust certificates, with authority to such depositary to make delivery thereof in exchange for voting trust certificates in accordance with the provisions hereof, and thereupon all further obligation or duty of the Voting Trustees under this Agreement shall terminate." The agreement of Sperry Corporation furnishes [10] a still different solution: "If at the expiration of six (6) years after the termination of this agreement any Trust Certificates shall not have been surrendered for exchange as here provided, the Depositary (agent for the trustees) shall deliver to the Corporation the stock on deposit at the time together with any dividends . . . with respect to such shares and any other cash or securities . . . and thereupon the Depositary shall be relieved of any and all further liability."

For a stock which pays dividends, the Baldwin Locomotive Works trust of 1937 provides [11] a solution to the problem of forcing the exchange of certificates for stock. "After the termination of this Agreement the holders of the Voting Trust

[9] Page 13. [10] Page 8. [11] Page 29.

Certificates shall not be entitled to receive any distributions, whether by the way of dividends or otherwise, in respect to the shares of stock or other securities or property deliverable under such Voting Trust Certificates except upon surrender of such Voting Trust Certificates for cancellation." If the trustees are really interested in hurrying the practical termination of a trust this provision should give them the power to do it, but they are apparently not required to put the provision into force.

DURATION OF THE TRUST

To secure some idea of the usual initial duration of voting trusts the following information about one hundred and thirty-eight trusts has been gathered. (It is important to note that extensions of the life of the trust have not been included.) Instead of 1924, the year 1926 is chosen as the dividing line because of the increasing leniency of the state statutes in respect to trusts.[12]

TRUSTS CREATED BEFORE 1926

Duration	*Number*
Five years	39
Ten years	8
Some other specific period	13
Indefinite	11 *
Perpetual existence	5
Total	76

TRUSTS CREATED SINCE JANUARY 1, 1926

Duration	*Number*
Five years	21
Ten years	33
Some other specific period	5
Indefinite	.3
Total	62

* Nine of these are railroad trusts created before 1915.

12 See Chapter VII.

Trusts having a five-year, ten-year or other specific duration include those terminating on the payment of a bond issue, or the like, and those ending in an explicit number of years. Trusts having an indefinite duration are terminated either by some complicated set of events or by some future event whose date cannot be foretold. Perpetual trusts are those which by their terms may never end.

From the above figures it may be seen that ten-year trusts occur most frequently in the second period, whereas in the earlier years five years is the popular duration. The growing use of ten-year trusts is further indicated by the fact that practically all of the real estate trusts created in the thirties are of this length. On the other hand, trusts of an indefinite duration and miscellaneous termination seem to have lost in popularity, so that the typical trust of today is limited to a specific term of either five or ten years and probably the latter.[13]

H. A. Cushing (writing in 1927) was of the belief that a "great majority" of the early trusts were created for five years because the New York statute permitted them for that period. [14] By the use of the same reasoning an explanation for the present use of ten-year trusts is possible since trusts of this length are permitted by most of the states, including New York, which changed its law in 1923. There is further evidence that the life of a trust may be determined by the law of the state in which it operates, as witness the twenty-one year trusts created in California for no better apparent reason than that the law of the state permits them.

Only a few of the trusts of recent years have been created for periods of longer than ten years, but as the state laws are

[13] Arthur S. Dewing writes that "Ordinarily, voting trusts terminate after a specified number of years, five commonly, or after a certain event or a combination of events has happened" (*Financial Policy of Corporations*, 1934, p. 398). However, in a footnote he cites Mr. Cushing's work of seven years before.

[14] Cushing, *Voting Trusts*, p. 22.

now more lenient in this respect an increase in the number may be expected.

The Interborough Rapid Transit Company trust (1922–1937) could have existed for thirty years in spite of a New York law limiting voting trusts to ten years. In theory, the trust was to last for a period of five years, but the trustees could, without action on the part of the certificate holders, extend the trust for five successive periods of five years. Another trust of long duration is that of the Pennsylvania Glass Sand Corporation (1927–) which need not end until 1960 on the retirement of a bond issue. The trusts of the Central Hollywood Building Company and Gaylord, Incorporated,[15] are for initial periods of twenty-one years. The Auditorium Hotel Company trust, an Ohio corporation, is to extend for fifteen years, since the law of the state permits trusts of this length. It is to be noted that none of the trusts created in the last fourteen years is perpetual.

METHODS OF TERMINATION

Usually a trust may be ended in several different ways, but no single trust agreement ever contains all of the possible methods or events of termination listed below. First, to enumerate the various provisions, an agreement may be terminated on or by the following:

(1) redemption of a given bond issue;
(2) reduction of a bond issue by a given amount;
(3) payment of interest for a certain period of time;
(4) redemption of preferred stock;
(5) reduction of the outstanding preferred stock;
(6) payment of dividends on the preferred stock;
(7) demand of a majority or more of the preferred stockholders;
(8) unanimous or majority vote of the trustees;
(9) death of the last surviving trustee;
(10) death of a single trustee;

[15] Both are California corporations.

(11) merger, consolidation, or sale of the company;
(12) vote of the majority, or some other stated percentage of the trust certificate holders;
(13) withdrawal of stock by the certificate holders to such an extent that a majority of the stock is no longer in the trust;
(14) vote of the certificate holders at a regular referendum; and,
(15) expiration of the trust.

The voting trust of the Baldwin Locomotive Works [16] may be terminated at any time by the unanimous vote of the trustees "and if, at any time prior to September 1, 1945, the aggregate principal amount of the Baldwin . . . Refunding Mortgage Bonds, 6% Convertible Series due 1950 . . . shall be reduced to four million dollars . . . or less, then this agreement may be terminated by the affirmative vote of a majority in interest of the holders of Voting Trust Certificates." In any event it shall end in eight years.

The Houston Oil trust, mentioned above, may be terminated by the trustees; or, after the redemption of the preferred stock, by two-thirds of the certificate holders; or, in the event it is not previously ended, fifteen years after the death of the last survivor of its three trustees. An even more complicated set of events, or means of termination, is found in the trust agreement of the Pennsylvania Glass Sand Corporation. The trust may be ended by the unanimous vote of the trustees; and, after the retirement of the first mortgage six percent bonds, by (a) the demand of two-thirds of the preferred stockholders; (b) when twenty thousand shares of the preferred stock shall have been retired; or (c) when by reason of sale, merger or consolidation no stock having voting power is held by the trustees.

Many of the railroad trusts have been of indefinite duration in that termination depended on the payment of a certain number of preferred dividends or the payment of bond interest. That of the St. Louis and San Francisco (1896) was to continue for five years, or until the first preferred stock

[16] Trust agreement, p. 28.

should receive a four percent cash dividend for two consecutive years, or it might be terminated by the trustees after 1902 with the consent of two-thirds of each class of stock. The Erie trust of 1895 was to terminate in five years, or when the first preferred stock received one four percent dividend. A more involved example was found in the trust of the Central New England Railway Company (1898–1911) which was to continue for ten years, or until four percent interest was paid on its bonds for two consecutive years, or until the bonds were made to bear a fixed rate of interest.

The Chicago Railways Company trust of 1908 was to last for four years and, beyond this point, to the extent permitted by law, until all of the consolidated mortgage bonds were paid.

When the trustees are given the power to time the happening of an event which automatically terminates the trust, they are placed in a difficult position, for, by sanctioning, say, the payment of bond interest, they may be voting themselves out of power. No doubt this fact has led many a trustee to see the financial position of his particular corporation in an unfavorable light. It should be mentioned, however, that this is of far greater historical than present importance, for few trust agreements now contain such provisions. The only discretion which trustees may exercise in this respect under most of the present agreements is to end them before their appointed time. Practically all trusts permit this, but the practical result is of little consequence as the power is rarely exercised.

The American Water Works and Electric trust might have been ended at any time by the unanimous vote of the trustees; while any holder of a trust certificate might have withdrawn his stock according to the agreement [17] on January 2, 1936, "by actually giving thirty days' notice in writing to the Voting Trustees of his intention to make such withdrawal and by surrendering on the withdrawal date the Trust Certificates

[17] Page 14.

representing the stock or securities so to be withdrawn." If, as a result of this, the trustees had no longer held a majority of the stock the trust was to have been terminated. Otherwise, it was to "continue thereafter for a period of five additional years." [18] It may be mentioned that the chances against such a withdrawal of stock were so great that it would have made little difference had a straight ten year trust been created instead. The advantage of including such a provision as this in the agreement lies in its effect on the prospective depositor, as he may be misled into thinking that the trust is to last only five years. However, even more difficult would be the termination of the trust by the certificate holders under some of the following agreements.

The Crown Zellerbach trust (1928–1937), with a ten-year duration, might have been terminated either by the unanimous vote of the trustees, or by the written request of three-fourths of the certificate holders. The ten-year trust of the Central Public Utility Corporation (1932–) may be ended by the written direction of the holders of eighty percent of the trust certificates; while the United Stores Corporation trust (1929–1939) could have been ended if the holders of twenty-five percent of the certificates had requested a meeting and at the meeting eighty percent of the certificates had been voted for the dissolution of the trust. A more practical means of termination is found in the trust agreement of the Belding-Hall Electric Corporation (1926–) in which the vote of four of the five trustees, or seventy-five percent of the certificate holders, would have sufficed.

In the case of Electrol, Incorporated (1936–) an unusual event of termination—the death of the sole trustee—is found. Here no provision is made for removal of the trustee, but the trust is to exist for five years only. The trust of the Consolidation Coal Company ends in the event of the merger or consolidation of the company; commonly an agreement

[18] *Ibid.*

provides that the trust shall continue after such a merger, with the trustees holding the new securities.

In the last few years a large number of real estate trust agreements have provided for regular referendums by the certificate holders to vote on the continuation of the trusts. For example, the Mar-Main Corporation (1935–) agreement requires a referendum every two years, but two-thirds of the votes are necessary to end the trust. The Constance Hotel Company trust (1937–) may be terminated by the affirmative vote of fifty-one percent of the certificate holders at a referendum to be held in 1940 and at least every two years thereafter. An even more generous trust, that of the Churchill Corporation (1937–), may be ended at any time by fifty-one percent of the certificate holders, and at referendums to be held at the end of the first, third, fifth, and seventh years, and in addition, the certificate holders may get their stock back at any time on the payment of certain nominal taxes.

Termination of a larger number of these real estate trusts is provided for by the vote of a given percent of certificate holders. The trust of the Lawrence-Winthrop Building, Incorporated (1936–) may be ended by the written request of fifty-one percent of the certificate holders, and a two-thirds vote is required in the case of the Eleventh and Baltimore Corporation (1937–). Not uncommonly, a larger percentage of the certificates must be voted for termination than for extension, as in the case of the New York Majestic Corporation (1937–) which requires a sixty percent vote for termination and only a fifty-one percent vote for a five-year extension. On occasion, certificate holders have exercised their right to terminate a trust, but this is most unusual. A case in point is the trust of the Riverside Drive and 103rd Street Corporation, ended just two years after its creation in 1936.[10]

[10] The study of the Securities and Exchange Commission found that most of the trusts created by the S. W. Straus committee of California, of which there are a number, might be terminated by a stated percentage of the holders

In summary, it may be said that the great majority of the trusts actually terminate at the expiration of a given period, and not, except in rare cases, because of the action of the trustees or the certificate holders.

POWERS OF VOTING TRUSTEES

Probably the most important part of the trust agreement is that which relates to the powers of the trustees. Ostensibly, the agreement vests full legal ownership of the stock in the hands of the trustees, but it is a rare agreement, at the present time, which leaves the matter here; it will commonly list either the restrictions on the trustee's powers, or the powers themselves, or both.

Cushing gives the impression that the rights of the trustees have become increasingly more circumscribed with the passage of time. He writes [20] that "by degrees limitations were imposed on the freedom of action of the trustees. . . . The practical tendency has been to confine the functions of the voting trustees to the choice of a board of directors, the receipt of dividends and the distribution of the amounts so received, and the discretionary power of terminating the trust." Such a statement as this tends to oversimplify the facts. Even though trust agreements have undoubtedly become more involved in this respect, there is no clear trend toward restricting the powers of the trustees. In any event it may be said with safety that a majority of the trust agreements place no substantial restrictions on the trustees.

There are three general types of agreements, in so far as their provisions relating to the powers of the trustees are concerned: those which place no restrictions on the trustees;

of the certificates (and of the income bonds, so long as any were outstanding). On the other hand, most of the American Bond and Mortgage Company issues, reorganized with a voting trust, provided for regular referendums. "But desirable as such a feature is, it is at best a cumbersome method of control over policy formulation by the trustees." (*Report on . . . Protective and Reorganization Committees,* Part III, pp. 203–4.)

[20] *Voting Trusts,* pp. 14–16.

those which mention only a few specific limitations; and those which have the effect of limiting the powers of the trustees over the ordinary operations of the business.

An interesting example of an agreement which places no restrictions on the trustees (subject to the observance of good faith on their part) is that of the Stuart Court Property Corporation (1937–).[21] "The Voting Trustees shall have complete and uncontrolled power to determine and act as they or a majority of them may in good faith deem to be for the best interest of the creditors and/or stockholders of the Company. . . . The Trustees may ratify . . . the sale or leasing or disposal in any manner of all or any part or parts of the property . . . even though such sale, lease or other disposal be . . . for a consideration and upon terms which will result in the whole of the proceeds of such sale, lease or other disposal being applied solely to the payment in full or in part of the indebtedness of the Company . . . without there being anything available for the stock of the Company." In defense of this provision it should be mentioned that all of the stock of this reorganized corporation was given to former bondholders in addition to the new bonds they received; hence, originally, at least, the stockholders and the bondholders were the same persons. Under another real estate trust "The Trustees are specifically authorized [in addition to a preceding provision giving them complete control] in the exercise of their unrestricted discretion . . . to vote for or consent to any increase, reclassification or reduction of the capital stock, or reduction in capital, of the Company, or any change to par value or in the par value of the shares of stock of the Company, that may lawfully be submitted for action by the stockholders." In the event of a merger or consolidation of the company with another company the trustees shall hold the new stock.[22]

The Consolidation Coal Company agreement (1935–)

[21] Page 9. [22] Starrett Corporation trust agreement (1936–), p. 10.

provides [23] that "the sole right to vote with respect to such shares of preferred stock [and common] and the right to otherwise direct, authorize or approve on behalf of said shares any corporate action of the Consolidation Coal Company, until the final termination of said trust, is vested exclusively in the said Voting Trustees; including the right to vote or act with respect to any amendment of the certificate of incorporation of the Company, the increase, reduction, classification or reclassification of its capital stock, or change in the par value, preferences, restrictions and qualifications of its shares, the creation of debts or liens, the making or amendment of its by-laws, the election and removal of directors, the acceptance of the payment of dividends otherwise than in cash and with respect to any other matter as to which a vote of a shareholder may be had." However, one relatively minor qualification of this absolute power is made: "The Trustees shall have no power to sell or assign the deposited shares of stock or, prior to the termination of the trusts, to transfer the same." [24]

A relatively short provision in the trust agreement of the Baldwin Locomotive Works grants [25] full control to the trustees: "Until delivery to the Certificate Holder of the share certificates held hereunder . . . the Voting Trustees shall possess . . . all of the powers of absolute owners thereof and all rights of every name and nature in respect thereof, including the full and unqualified right and power to vote (in person or by proxy) for every purpose, and to consent to any corporate act of the Company and to waive notice of any meeting of shareholders, it being expressly stipulated that no voting right passes to any person other than the Voting Trustees." Later in the agreement it is specifically provided that in case of a merger or consolidation of the company with another company the trustees shall hold the new stock.

Mention may be made of the following trust agreements, not arising from reorganizations, which place no restrictions

[23] Page 6. [24] *Ibid.*, p. 4. [25] Page 16.

on the powers of the trustees: Columbia Pictures Corporation (1930–), American Commercial Alcohol (1928–1933), and the Compo Shoe Machinery Corporation (1930–).

The second type of trust agreement is that which places a few specific restrictions on the trustees, but which may also list many of their rights and powers. The agreement of the Sperry Corporation (1933–) includes the following in a long list of purposes for which the trustees may vote the stock: to amend the certificate of incorporation of the company; guarantee the bonds or other obligations of any corporation; change the number and powers of the directors; change the par value of the company's capital stock; change the rights and preferences of the several classes of capital stock; issue any increased stock for cash or property to whomsoever the trustees please; and anything else not specifically here mentioned. But, without the assent of a majority of the certificate holders, secured at a meeting called for the purpose, the trustees may not authorize any of the following: "(a) the sale, exchange or other disposition of all or substantially all of the properties and assets of the Corporation; (b) the mortgage or pledge of all or substantially all of the properties and assets of the Corporation; and (c) the merger or consolidation of the Corporation with any other corporation . . . where such merger or consolidation would result in a sale, exchange or other disposition of all or substantially all of the properties and assets of the Corporation." [26]

By comparing the powers retained by the trustees to those rights given up, it is obvious that the restrictions are of little consequence. The inability of the trustees to create a mortgage without the consent of the certificate holders is of small concern when contrasted with their power, say, to change the corporate charter. The certificate holder's position would be little changed if the restrictions were removed from the agreement entirely.

The Central Public Utility agreement of 1932 includes [27]

[26] Sperry Corporation trust agreement Article Ninth.

[27] Page 13.

no restrictions on the power of the trustees except "that no action may be taken . . . to wind up or dissolve the Corporation or to dispose of or lease the whole or substantially all of its property or assets and/or merge or consolidate the Corporation with any other corporation . . . without the consent . . . given by the holders of voting trust certificates representing not less than two-thirds in amount of the shares of Common Stock represented thereby." Under a similar provision the holders of three-fourths of the trust certificates of the United Merchants and Manufacturers (1928–) must agree to the sale, merger or reorganization of the corporation.

The voting trustees of the Wickwire Spencer Steel Company (1925–1931) [28] could make "any increase in its funded or other debt" and issue "additional capital stock for cash and/or property and/or services," but they could not sell or consolidate or merge the corporation with another without the assent of a majority in interest of the certificate holders. Similarly, under the Morewood Corporation trust of 1933 (a real estate company) a majority of the certificate holders must assent to the consolidation, merger, sale, or lease of the corporation.

A new development of the last few years in the trust agreements of a number of real estate companies is the inclusion of a provision that permits the trustees to sell, merge, or mortgage the property if, say, one-third of the certificate holders do not object in writing. Such a provision is contained in the trust agreements of the Coronado Hotel Company, the Art Center Apartments, and the 5801 Dorchester Corporation; while the property of the Westbrook Buffalo, Incorporated, may not be sold if one-third of the certificate holders and the bondholders object. Provisions such as these place the trustees in a strong position when they desire to sell the company's assets; for, while it is unlikely that one-third

[28] Fourth Article of the trust agreement.

will dissent, it is relatively difficult to secure the assent of two-thirds of the certificate holders.

Under the third type of trust the restrictions placed upon the power of the voting trustees are so extensive that their effect is to limit control to the ordinary business of the corporation. The trust of the American Water Works and Electric Company, Incorporated (1931–1933), was of this type. Without "the consent of the holders of record of Trust Certificates representing at least a majority of the shares of the Common Stock of the Company at the time held in the trust hereunder,[29] given in writing or at a meeting . . . ," the trustees might not vote the stock held in the trust for the following purposes (among others): the increase, change in or reclassification of the authorized capital stock; the amendment of the charter of the company; the mortgage, pledge, or encumbrance of any of the assets of the company; the creation and issue of bonds; the guaranty of the obligations of any other company; the recapitalization or reorganization of the company; and the liquidation, merger, consolidation, sale, or lease of the company or any part of it.[30] This sample of the restrictions placed upon the trustees by this agreement should be sufficient to show that there is little left to their discretion other than the selection of the directors.[31]

Similar to the trust agreement of the American Water Works, is that of the Consolidated Cement Corporation (1935–).[32] "The Voting Trustees . . . shall have power to use and manage any property or assets which may be held at any time under the Trust . . . in all respects as if such

[29] Not all of the stock of this company was held in trust, so that as a matter of fact a majority of the stock and the certificates combined need not have been voted in favor, say, of the sale of the corporation. If 51 percent of the stock was in the trust, and 51 percent of the certificates was voted for the sale, the sale would be permitted even though all of the stock not in the trust was voted against it.

[30] American Water Works and Electric Company, Inc., trust agreement, Seventh Article.

[31] See Chapter V.

[32] Trust agreement, pp. 3–4.

property or assets were the individual property or assets of the Voting Trustees." (1) They may receive and distribute dividends; (2) vote in person or proxy the stock of the company for the election of directors; (3) consent to any act of the corporation; and (4) appoint or employ transfer agents, registrars, depositaries and counsel. The trustees may not, however, vote for the following (without giving thirty days' notice to the certificate holders and securing assents from the holders of at least two-thirds of them at a meeting or by writing): (1) create bonds or notes maturing in more than twelve months, except purchase money mortgages not in excess of 50 percent of the value of the property securing them; (2) change, increase or decrease the number of shares of authorized stock, create new stock, or issue bonds convertible into stock; (3) redeem any of Class A Stock; (4) recapitalize the company in such a manner that the relative position of the two classes of stock is changed; (5) sell, mortgage, lease, or dispose of all or substantially all of the assets of the company; (6) merge or consolidate the company; (7) dissolve or liquidate the company; and (8) amend the certificate of incorporation in respect to the relative powers and rights of the two classes of stock. Though these restrictions are not so severe as in the two preceding examples, they do significantly limit the power of the trustees.

The trust agreement of the Universal Corporation (1936–) explicitly provides [88] that the power of the trustees shall be limited to the ordinary business of the company. The trustees "(1) may in their discretion at any time vote, consent or take any action in regard to (a) the election and/or removal of any director or directors of the Corporation which such Voting Trustees deem desirable, or (b) the ratification, confirmation or approval of any action taken by the directors or officers of the Corporation in the ordinary course of business of the Corporation, but (2) shall not vote, consent or take

[88] Page 9.

any action in regard to any matter or matters, whatsoever, except those enumerated in (1) above, unless and until the Voting Trustees shall have been expressly authorized . . . to so vote, consent or take such action, by the holders of record . . . of the voting trust certificates . . . representing at least the number of shares of stock that is required by law or otherwise to authorize, consent or to approve the matter or proposal under consideration." It will be noted, in contrast to the preceding trust agreement, that a proportion of the total stock issue and not of the trust certificates only must be voted in favor of any action proposed by the trustees.

One of the older agreements, that of the International Nickel Company (1911–1917), is similar to the trust of the Universal Corporation. By its terms,[34] the trustees could vote the stock for the election of directors, and for "all routine or ordinary matters and business of the Company," but all other matters had to be submitted to the certificate holders. No doubt the fact that Mr. Cushing refers [35] to this trust as an example of "an extreme limitation" placed upon the powers of the trustees, indicates the relative scarcity of such restrictions.

DESIGNATION OF DIRECTORS

On occasion, voting trust agreements require that the trustees elect the directors of the corporation in a specified manner. The agreement of the Starrett Corporation provides that the trustees elect John O'Brien as one of the directors, or in the event of his death, one of the seventeen men named in

[34] Page 4.

[35] *Voting Trusts,* p. 58. With reference to such restrictions, he writes that "such provisions protect the substantial property rights of the certificate holders, and are therefore doubtless justifiable, although they involve a qualification of the complete exercise by the trustees of the rights of legal owners. Such a qualification, however, by way of contract or declaration of trust is not deemed to be either inconsistent with the rights of the trustees as legal owners or obnoxious to public policy" (p. 67). It is interesting that this writer should feel called upon to justify provisions in the trust agreement which tend to protect the beneficial owners of the stock.

the agreement. The trust of the Consumers Company of Illinois (1937–) gives each trustee the right to select one of the five directors. The Rochester Gas and Electric Corporation trust (1932–) provides that ten of the directors shall be chosen by the trustees, and that five shall be nominated by the certificate holders and elected by the trustees.

A more complicated arrangement for the election of directors was recorded in the agreement of the Interborough Rapid Transit Company (1922–1937). The trustees were required to elect as directors three persons nominated by the trust certificate holders: one nominated by the Manhattan Railway Company; one, by the first and refunding mortgage bondholders; and one, by the public authorities of the City of New York. The agreement of the American Sumatra Tobacco Corporation (1926–1927) provides that one trustee shall choose two directors; one trustee shall designate one director; these two trustees together shall elect one director; two trustees shall designate four directors; and, on the death of a specified trustee, four shall choose one director. Altogether, there are only five trustees, as they are grouped together in various ways for the purpose of choosing the directors.[86]

Section 12 of the agreement of the American Hardware Company (1928) provides that the trustees, in voting the stock deposited with them, shall elect directors to represent the interests merged into the American Hardware Company Incorporated, "in accordance with the present representation, that is to say, four directors shall be elected from the stockholders of the American Hardware Co., Inc., who were holders of stock prior to said merger and who continued as such, . . . two shall be elected from those who were stockholders of the Totly Trunk and Bag Co., Inc., . . . and one shall be elected from those who were stockholders of the Independent Trunk and Bag Co., Inc., . . . and one shall be elected from those

[86] See also the trust agreements of the United Electric Coal Companies and the Worthington Pump and Machinery Corporation.

who were stockholders of the Holden Trunk and Bag Co., Inc.".[37]

Far more common than this arrangement is the usual one, in which the stock held in the trust is to be voted according to the desire of the majority of the trustees. Some of the state laws include a provision to this effect in case the trust agreements do not specify how the stock is to be voted.

INSTRUCTING TRUSTEES ON HOW TO VOTE

In rare cases the bondholders of a reorganized corporation have been given the right to instruct the trustees as to how they should vote the stock held in the trust. In the Mobile and Ohio reorganization, mentioned above and that of the South Carolina Railroad,[38] this was done. The trust agreement of the Mortgage Service Company of Philadelphia (1934–) provided that within two years after its reorganization the creditors should nominate the directors to be elected by the trustees. Apparently the court was to determine the date of the nominations and elections.[39]

In view of the fact that it is difficult to criticize a trust when voting rights are given to the creditors or certificate holders, it is surprising that this has not been done more often. When used in connection with a reorganization, an agreement giving voting power to the beneficiaries will serve its legitimate purpose as well as any and at the same time not arouse antagonism.

RESTRICTIONS ON THE PAYMENT OF DIVIDENDS

Occasionally the powers of the trustees have been restricted by the inclusion in the agreement of a provision limiting the payment of dividends by the corporation. The Consolidated Cement trust provides [40] that "No dividends shall be paid or

[37] *Steward* v. *American Hardware Co.*, 171 SE 650.

[38] See Cushing, *Voting Trusts*, p. 58.

[39] U.S. House of Representatives Subcommittee on Investigation of Real Estate Bondholders' Reorganizations. Public Hearings, Part 15, pp. 567–73.

[40] Page 2.

accrued on or set apart in respect to the shares of Class B Stock of the . . . Corporation . . . until all of the 15-year First Mortgage 6% Cumulative Income Bonds . . . shall have been retired." Similarly, the trustees of the Interborough Rapid Transit could not vote to pay dividends on the stock of the company before 1926, nor in excess of seven percent in any year before 1950.

RIGHT OF TRUSTEES TO CONSTRUE THE AGREEMENT

Quite commonly, at the present time, trust agreements permit the trustees to interpret the agreement. Thus, "The Voting Trustees may supply defects and omissions in this agreement and may make such reasonable modifications thereof as, in their judgment may be expedient or necessary to give effect hereto." [41] The agreement of the Consolidation Coal Company states [42] that "The trustees are authorized and empowered to construe the agreement and their construction of the same, made in good faith, shall be final, conclusive and binding upon all holders of voting trust certificates." The Baldwin Locomotive and the Morewood Corporation agreements contain almost identical provisions.[43] The necessity for such provisions is not clear, and even Cushing, who warmly defends voting trusts, seems to have some doubt as to the propriety of making them. He writes [44] that "Such grant of power may seem excessive in the ordinary case, and especially if by its use the trustees might enlarge their own powers, but it may be justified in those more complicated agreements which, extending possibly for two or three decades, are plain under present circumstances but which might be obscure as applied to later developments." This apologia notwithstanding, the effect of provisions of this type may be

[41] American Commercial Alcohol Corporation trust agreement, 1928, Section 10.

[42] Page 18.

[43] Baldwin Locomotive agreement, p. 30.

[44] *Voting Trusts*, p. 99.

to eliminate from the agreement all restrictions placed on the powers of the trustees.

RIGHT OF TRUSTEES TO DEAL WITH THE COMPANY

Many present-day trust agreements provide that the trustees may contract with the company regardless of any adverse interest of their own. Most of these provisions are similarly worded; two or three illustrations will, therefore, afford a sufficiently accurate portrayal of their contents. For example, any trustee may "be or become pecuniarily interested directly or indirectly in any matter . . . to which the Corporation . . . may be a party. . . . No trustee having such adverse interest shall be liable to the Corporation . . . or to any holder of any voting trust certificate . . . for any loss incurred by it under or by reason of any such contract or transaction; . . . provided, always, however, that such contract or transaction shall at the time at which it was entered into have been a reasonable one . . . and upon terms that at the time were fair." [45] An amusing stipulation is found in the following: "Any Voting Trustee . . . may contract with the Corporation, or be or become pecuniarily interested in any matter or transaction to which the Corporation may be a party . . . provided, however, that the general character and extent of such interest, if any, of any such Voting Trustees shall be disclosed to the other Voting Trustees *upon any request therefor*." [46] By this, a trustee with an "adverse interest" appears to be relieved of liability so long as he can avoid denying it!

The Sperry Corporation agreement [47] reads as follows: any trustee, "or any firm of which he may be a member, or any corporation of which he may be a member, or any corporation of which he may be a stockholder, director, or officer, may, to the extent permitted by law, contract with the Cor-

[45] Central Public Utility Corporation agreement, pp. 19–20.
[46] Universal Corporation agreement, p. 18. Present writer's italics.
[47] Article Eighth.

poration of any controlled or subsidiary company, or be or become pecuniarily interested in any matter or transaction to which the Corporation or any controlled or subsidiary company may be a party, or in which the Corporation or any controlled or subsidiary company may in any way be concerned, as fully as though he were not a Voting Trustee."

Probably indicating the infrequency of such provisions in the past, Mr. Cushing, whose work concentrates on the period before 1915,[48] makes no mention of them.

DUTIES AND LIABILITIES OF TRUSTEES

Like many other parts of the trust agreement the one that covers the duties of the trustees is likely to be a trite statement copied from some previous agreement. The Consolidated Cement agreement provides [49] that "In voting or giving directions for voting the securities deposited hereunder, the Voting Trustees will exercise their best judgment, from time to time, to select suitable directors, to the end that the affairs of the . . . Company shall be properly managed, and in voting or giving directions for voting and acting in other matters for stockholders' action, the Voting Trustees will exercise like judgment." In this respect the agreement is almost identical with that of many other trusts.[50]

Probably most contemporary trust agreements relieve the trustees of all liability except for their own malfeasance. For example, to continue with the quotation in the preceding paragraph, it is found that the trustees "assume no responsibility in respect to such management or in respect to any action taken by them . . . except for their own individual malfeasance." The International Nickel trust goes further: [51] a trustee shall not be liable "except for his own individual gross negligence or wilful misconduct." The Baldwin Locomotive agreement provides [52] that "No Voting Trustee . . . shall

[48] This is the date of the first edition of his book. [49] Page 8.
[50] Cushing, *Voting Trusts*, p. 54. [51] Page 6. [52] Page 24.

incur any liability by reason of any error of law or fact or mistake of judgment or by reason of any matter or thing done or omitted under this agreement, except for his own individual, deliberate and wilful malfeasance."

But many of the agreements do not stop here. Thus the Baldwin agreement provided [58] that "The Company . . . hereby indemnifies the Voting Trustees and agrees to hold each and all of them harmless from and against any and all claims and liabilities in connection with or arising out of the administration of the Voting Trust created by this Agreement and the issuance of Voting Trust Certificates and/or Scrip hereunder, except that no Voting Trustee shall be entitled to the benefit of such indemnification if such claims or liabilities shall arise from his own individual, deliberate and wilful malfeasance." The trust agreements of the American Water Works and the Consolidation Coal Company are almost identical in this respect.

These provisions first relieve the trustees of any liability and then provide that the company shall reimburse them for any claims which may be made against them. But in the event that the trustees are actually relieved of liability by the first provision, the second one is not necessary, so far as suits by the depositing stockholders are concerned.

Since the courts do not appear to have ruled on the effect of these immunity clauses in voting trust agreements it is proper to examine briefly an analogous situation with respect to provisions relating to trustees under bond indentures. Fletcher writes that "As a general rule, the parties to a corporation mortgage or trust deed may, by their agreement, limit the liability which is imposed on one and accepted by another, and such provisions are valid. . . . But the law, through considerations of public policy, determines a point beyond which the parties cannot by agreement relieve a trustee from liability for breach of a trust duty. For instance, a

[58] Page 26.

trustee cannot contract for immunity from liability for acts of gross negligence or for acts done in bad faith." [54] Assuming that the courts take the same attitude toward immunity clauses in voting trust agreements it may be readily seen that such clauses are not without some effect.

EXPENSES AND COMPENSATION OF TRUSTEES

The typical trust agreement makes some provision for payment of the expenses of the trust and often for the compensation of the trustees. In the past this was not so, possibly because the trustees could always have the corporation pay the expenses of the trust if they so desired; but in keeping with the increasing complexity of agreements, such provisions are now usually inserted.[55]

The expenses of the trust and the compensation of the trustees may be paid either by the corporation or deducted from the dividends received from the company. The more usual method is for the corporation to pay them, in part because of the psychological advantage of not having the expenses deducted directly from dividends.[56] However, the trust agreement of the American Commercial Alcohol Company provides [57] that the voting trustees "shall be entitled to a reasonable fee, and other expenses for attendance at meetings of the Voting Trustees, and may pay to themselves such fees and

[54] *Cyclopedia of the Law of Private Corporations*, VII, 361–62. In spite of the "general rule" quoted above there appears to be considerable diversity of opinion among the courts. Thus in *Newhall* v. *Morristown Trust Company* (280 Pa. 195, 1924) the trust company was held to be exempt by the provisions of an immunity clause from liability for wrongful delivery of bonds by the mortgagor to contractors who failed to carry out their part of a contract with the company. On the other hand in *Patterson* v. *Guardian Trust Company* (144 App. Div. 863, 129 N.Y. Supp. 807, 1911) the court said that "it would seem too clear for argument that the plainest principles of justice require the implication of a covenant imposing upon the defendant the obligation to exercise ordinary viligance and intelligence in protecting the proceeds of the bonds, and to see that they are applied to the payment of the prior mortgages."

[55] Cushing, writing in 1927 (*Voting Trusts*, p. 46), mentions the increasing use of such provisions.

[56] There may also be a tax saving.

[57] Section 10.

expenses out of any dividends, funds or other property which may come into their possession." The relevant provision of the General Theatres Equipment trust agreement states that the trustees shall not receive any compensation, but that their expenses shall be a lien upon the shares of stock deposited in the trust.

The Universal Corporation agrees to pay the expenses and compensate the trustees in the following provision: "The Voting Trustees shall not receive any compensation for their services unless the Corporation shall by a vote of the Board of Directors, determine to compensate one or more of the Voting Trustees." And later in the agreement: [58] "it is anticipated that provision will be made for the payment by the Corporation of the expenses incurred by the Voting Trustees under this Agreement, the compensation, charges and expenses (including counsel fees) of the Agents herein designated, and of any agents from time to time appointed by the Voting Trustees hereunder, and of counsel for the Voting Trustees, and all other expenses incurred in good faith by the Voting Trustees hereunder; but if such expenses are not so paid, the holders of the voting trust certificates agree to pay the same *pro rata* and the Voting Trustees shall have a lien therefor on all stock certificates . . . held by them hereunder." This particular provision appears to be unusually detailed, but it does not differ in substance from many others. The American Writing Paper Company agreed [59] that "The Voting Trustees shall be entitled to reasonable compensation for their services as Voting Trustees under this agreement, and shall be authorized in all cases to pay such reasonable remuneration" to their agents. The Baldwin Locomotive Works and the Central Public Utility trusts have provisions similar to this.

Both the Morewood Corporation and the Pennsylvania Glass Sand trusts provide that if the corporation does not pay

[58] Page 22.

[59] Article Twelfth.

the expenses of the trust the amount may be deducted from any dividends that may be received by the trustees. The trust agreements of the Gorham Manufacturing Company and the Creameries of America provide that the corporations shall pay the expenses of the trust, but make no mention of the compensation of the trustees.

In unusual cases the amount of the compensation of the trustees is specified in the agreement. A small real estate company trust agreement provides that the trustees shall be paid $150 a year by the corporation.[60] In addition, however, one of the trustees receives $720 a year as president of the company. The Consolidated Cement Corporation agrees [61] to compensate its trustees as follows: "The compensation of the Voting Trustees for their services as such shall be limited to One Thousand Dollars per year for each Voting Trustee, and the Voting Trustees are not to receive any other compensation in any form for their services as such Trustees, provided, however, that any Voting Trustee receiving compensation from the Company in the capacity of officer or employee shall not be entitled to receive any compensation as a Voting Trustee."

The voting trust agreement of the International-Great Northern Railroad Company provided that in the event of the sale of the stock held in trust that the trustees might deduct from the proceeds one dollar per share. Such a sale was made two years later (1924) and a commission of about seventy-five thousand dollars was collected by the trustees.

A special dividend was paid by the Central Hudson Gas and Electric Corporation, amounting to seven cents per share, for the purpose of supplying the trustees with funds for the payment of transfer taxes on the return of the stock held in the trust. The stockholders whose stock was not in the trust received the dividend. And in a somewhat unusual trust, arising out of a reorganization, the *court* retained the right to fix the compensation to be paid the trustees and their successors

[60] Stuart Court Property Corporation.

[61] Page 7.

for their services. The company in this case was to pay the expenses of the trust and compensate the trustees.[62]

FILLING VACANCIES

Trust agreements always make some provision for filling vacancies that result from the death or resignation of trustees. The most common method is to have the remaining trustees fill such vacancies. This simple arrangement was used by the trusts of the Houston Oil Company of Texas, the Gorham Manufacturing Company, the Compo Shoe Machinery Corporation and the Columbia Pictures Corporation, among many others. If a vacancy among the trustees of the Creameries of America is not filled by the remaining trustees in three months, the certificate holders may fill it. (This provision has become fairly common of late, probably because in many instances in the past trustees have not filled vacancies in their own ranks.) Under the Sperry Corporation trust agreement vacancies are filled by unanimous vote of the trustees; while the trust agreement of the American Seating Company provides that successor trustees "shall be males."

The successors for two of the trustees of the American Water Works and Electric Company are named in the agreement and the third is to be named by another company. In the event that a vacancy shall not be filled in ninety days, the president of the Chemical Bank and Trust Company shall fill it. Two vacancies among trustees of Sulzberger and Sons (Wilson and Company since 1916) were to be filled by the Guaranty Trust Company of New York; one by the remaining trustees; and two by the survivor of the remaining trustee. Under the trust agreement of the United States Hoffman Machinery Corporation (1922–1927) two of the vacancies were to be filled by two investment banking houses and the third by the remaining trustees.

Under the Pennsylvania Glass Sand trust two of the va-

[62] Consumers Company of Illinois.

cancies are to be filled by two of the banking houses which underwrote the bond issue of the company; two trustees appoint one another's successor; and the fifth is elected by the remaining four. Often, however, vacancies are filled by other companies which are not investment bankers. The trust agreement of the Rio Grande Valley Gas Company (1917–) provides that the places of two of the trustees shall be filled by the Hope Engineering Company, and on the death of the third trustee his successor shall be named by the Youngstown Sheet and Tube Company. Similarly, one of the vacancies of the Central Public Utility Corporation trust is to be filled by three other utility companies, while the successors of the other two are to be elected by the remaining trustees.

The successors of the trustees of the National Distillers Products Corporation (1928–1938) were to be appointed by the Equitable Trust Company of New York, the Chase Securities Corporation, and the Bankers Trust Company of New York. Two of these banks were to appoint two additional trustees in the event that preferred dividends were not paid for one year. All vacancies were to be filled in the case of the American Commercial Alcohol trust by the National City Company (of New York).

There is practically no end to the diversity of methods which may be used to fill vacancies among the trustees. The successors of three of the trustees of the L. C. Smith and Corona Typewriters, Incorporated, were to be appointed by the representatives of the estates of the decedent trustees, while the four other successors were to be selected by four different companies. In the unusual case of the Starrett Corporation one of the vacancies is to be filled by the holders of the company's income bonds in the event it is not filled by one of two named successors. The voting trustees of the American Sumatra Tobacco Corporation were to select their own successors by filing with the depositary a list of the names of the men to succeed them.

The voting trust agreement of the Baldwin Locomotive

Works creates two classes of trustees; two are Class B and three are Class A, and the remaining trustees of each class are to elect their own successors.

It is evident from the number of trusts in which bankers appoint the successor trustees that many companies are controlled by investment bankers through the use of voting trusts. In fact, this is often the only way in which an outsider can determine the relationship of trustees to the corporation. In a later chapter we shall discuss this point further.[63]

In connection with the filling of vacancies among the trustees it should be pointed out that practically all trust agreements provide for the resignation of the trustees. The usual provision permits a trustee to resign upon the delivery of a written statement of his desire to do so either to the other trustees or to the trust company which is the agent of the trustees. The Gold Dust Corporation trust (1923–1938) provided [64] that any "Voting Trustee may at any time resign by delivering to the other Trustees his resignation in writing to take effect ten (10) days thereafter, unless sooner accepted by the remaining Voting Trustees." The trust agreement of the Consolidation Coal Company states [65] that "Any Trustee may resign by delivering his resignation in writing to their said Agents."

AGENTS OF THE TRUSTEES

Probably without exception at the present time trust agreements provide that the agents of the trustees, unless specifically named in the agreement, are to be appointed by the trustees themselves. Often a trust company which is to be an agent of the trustees is a party to the agreement. Whether the agents are named in the agreement or not makes little difference, however, customarily in either case the trustees have power to remove any agent [66] and substitute another in its place. Moreover, even though the agent may be a party to the

[63] See Chapter V. [64] Tenth article. [65] Page 16.
[66] The agent will almost invariably be either a corporation or a law firm.

agreement, it almost always may resign at its own convenience.

The services performed for the trustees by the agent or agents are several. The trust agreement commonly provides that a trust company shall act as depositary for the stock held under the trust, and that the same trust company or others may act as transfer agent for the voting trust certificates and as registrar. In addition to these corporate agents the trustees, as we have seen, often have the right to choose their one legal counsel to be paid by the corporation.

Like the trustees, the agents are usually relieved of liability by the trust agreement. For example, the trust agreement of the Central Public Utility Corporation reads [67] that "No Agent or Depositary named herein . . . shall incur any liability whatever for anything done or omitted to be done at the request of the trustees." In a like manner the trust agreement of the Baldwin Locomotive Works stipulates [68] that "Neither of said Voting Trust Agents nor any other agent of the Voting Trustees shall incur any liability whatsoever for anything done or omitted to be done at the request or direction of the Voting Trustees or otherwise except for its own wilful misconduct." In addition to a similar provision, the agreement of the Consolidation Coal Company provides that the [69] company "will indemnify and save harmless the said Trustees and the said Agents and the said Registrar from all loss, expense and liability incurred by them or any one of them by the execution of the trusts of the agreement."

AMENDMENT OF THE TRUST AGREEMENT

Some voting trust agreements provide for their own extension or amendment. The Stuart Court agreement provides [70] that "This agreement shall be automatically extended for a further five year period upon the affirmative vote or written consent of the holders of Voting Trust Certificates represent-

[67] Page 7. [68] Page 24. [69] Page 24. [70] Page 11.

ing at least fifty-one per cent of the total amount of stock then outstanding." But if at that time the New York law permits, there will be "an automatic extension of this Agreement on the failure of the holders of Certificates to vote against such extension." It is of interest to note that the prospectus for these certificates (under the Securities Act of 1933) says that the trust will continue for a maximum period of ten years, and not five plus a five year extension.

The trust agreements of the Sperry Corporation, the Columbia Pictures Corporation, and the Consolidation Coal Company all provide for amendment by the vote of a majority in interest of the holders of the voting trust certificates. Presumably these provisions permit the extension of the agreement. Thus a certificate holder desiring to withdraw his stock at the end of the trust may be prevented from doing so, if a majority of the holders desire to extend the trust. The Consolidated Cement trust may be amended only by the unanimous vote of the voting trustees, and by the assent of at least two-thirds of the entire issue of Class A trust certificates obtained at a meeting of the holders called for the purpose. Class B certificate holders are given no right to vote on amendments. The New York Stock Exchange listing statement for the trust certificates of the Columbian Carbon Company mentions that the trust of this firm may be extended by the vote of a majority of the certificate holders. However, it is not clear whether or not certificate holders may withdraw their stock on the extension of the trust. The listing statement implies that they may do so, but all of the stock of the company has been held in the trust in spite of its extension on several occasions.

MEETINGS OF CERTIFICATE HOLDERS

In discussing the restrictions placed upon the powers of the trustees, reference was made to meetings of the certificate holders. The trust agreement of the Sperry Corporation, men-

tioned above in this connection, states [71] that "The Voting Trustees may, in their sole and uncontrolled discretion, call a meeting of the Trust Certificate holders for the purpose of ascertaining their views upon any question. Such meetings shall be held at the principal office of the Corporation . . . , or at any other place, . . . that the Voting Trustees may name in the notice of the meeting. Such notice shall set forth the time, the place and the purpose of the meeting and shall be mailed at least ten (10) days before the date of such meeting to each of the Trust Certificate holders of record who shall not have waived such notice. . . . At such meeting every Trust Certificate holder shall have one vote for each share of stock represented by Trust Certificates standing in his name and may vote in person or proxy. . . . Notwithstanding any such expression or view ascertained at any meeting called by the Voting Trustees, the Voting Trustees may, in their sole and uncontrolled discretion, act upon in whole or in part, or may disregard entirely any such expression or view." Provisions similar to this are common in trust agreements; in fact, that of the Gold Dust Corporation is almost identical.

In some cases the trustees have been given the right to call a meeting of the certificate holders, even though there are no restrictions placed upon the power of the trustees. This, for example, was the case with the trust of the American Seating Company. The Bank of America trust agreement, which also placed no restrictions on the power of the trustees, reads as follows: [72] "The trustees may, in their sole discretion, notify the Certificate Holders in regard to any proposed exercise by the Trustees of any of the rights, powers, or privileges vested in them, and may act in accordance with any request of a majority in amount of the Certificate Holders by voting or consenting, as so requested, with respect to all shares held by them as Trustees, but the Trustees shall not be bound to follow any such request."

[71] Article Ninth.

[72] Section 16.

Only when the trustees are required to call a meeting of the certificate holders for certain purposes are provisions of this type of any significance. On occasion the trustees have requested the approval of the certificate holders before taking certain action not requiring such assent, but the cases do not justify any extended discussion of this part of the trust agreement.[73]

WITHDRAWAL OF STOCK

Another new development following the depression of 1930 has been the inclusion in some real estate trust agreements of a provision permitting the certificate holders to withdraw their stock at any time. Such a clause is found, for example, in the agreements of the Chicago Allerton Hotel Company, the Chicago Medical Arts Building Corporation, the Auditorium Hotel Company, the Kenmore Hotel Company, and 1617 Belmont Company. The only qualification of this right is that the withdrawing stockholder must pay the transfer and stamp taxes which would otherwise be paid by the corporation. In addition, the same stockholder, as such, will in effect pay his *pro rata* share of the taxes paid by the corporation on the transfer of the other stock in the trust on the termination of the agreement. Thus, if only a small amount of stock were withdrawn prior to the termination of the trust, the withdrawing stockholder might find himself paying a tax, directly and indirectly, almost twice as great as he would otherwise pay.[74]

[73] Cushing mentions (*Voting Trusts,* p. 60) the case of the trustees of the Southern Railway who requested the assent of the certificate holders to a proposed bond issue.

[74] The doubled tax, here cited, represents, of course, an outside limit that, assuming no change in the tax rate, would be approached but never reached. The smaller the proportion of stock withdrawn, the closer the limit is approached. For example, if one share out of a possible 100,000 shares were withdrawn, the withdrawing stockholder would pay a transfer tax on that share plus another transfer tax on $\frac{99,999}{100,000}$ of a share. At the other extreme, if all the 100,000 shares were withdrawn, the transfer tax on each share would be paid just once, or, in mathematical language, it would be a transfer tax on 1 share plus $\frac{000,000}{100,000}$ of another share.

Since the tax on the transfer of certificates is small, this qualification is of little importance. The fact remains that any trust which may be so easily terminated, in effect, cannot be subject to much criticism. It is a safe conjecture to say that considerable stock is likely to be withdrawn from a trust of this type.

Real estate trust agreements, so far as the writer knows, are the only ones that have contained this provision. The nearest approach to this stipulation to be found in an industrial trust agreement is in that of the Houston Oil Company, previously mentioned. Here the certificate holders may secure proxies to vote their stock at any stockholders' meeting, and, if ten percent of them demand it, a meeting is to be called to consider the removal of any voting trustee and the election of a new one. Cushing mentions [75] the case of the agreement of the Quaker Oats Company which provided for the yearly election of the trustees by the certificate holders.

MINOR AND UNUSUAL PROVISIONS

Some trust agreements provide that the corporation shall pay any dividends which may be declared on the stock held in the trust directly to the certificate holders rather than to the trustees. A typical example of the conferring of this right is found in the agreement of the American Water Works and Electric Company: [76] "The Voting Trustees may in their discretion, from time to time, instead of receiving and distributing any such dividends or distributions, authorize the Company to make payment or delivery thereof directly to the holders of the Trust Certificates." The same right is conferred by the trust agreements of the Central Public Utility Corporation, the Consolidation Coal Company, the American Seating Company, and the American Writing Paper Company.

Probably without exception every trust agreement in recent years contains some such provision as the following: "In

[75] *Voting Trusts*, p. 106. [76] Page 12.

case any Trust Certificate issued under this Agreement shall become mutilated or destroyed or stolen or lost, the Trustees, in their discretion, may authorize the issue of a new Trust Certificate, and thereupon the Agent of the Trustees shall issue a new Trust Certificate in exchange therefor for a like number of shares and bearing a like serial number. The applicant for such substituted Trust Certificate shall furnish to the Trustees and to their Agent evidence to their satisfaction, respectively, of the mutilation, destruction, theft, or loss of such Trust Certificate, together with such indemnity to both the Trustees and/or their Agent, respectively, as in their discretion, they may require." [77]

Most trust agreements provide for the inspection of the agreement by certificate holders, usually at the office of the company. Even if the agreement does not contain such a provision, however, most of the states which have legislated on the subject of voting trusts require that the certificate holders be extended this privilege.[78]

The trust agreement of the Consolidation Coal Company contains [79] the following unusual provision: "The list or register of holders of voting trust certificates for stock of either class shall be open to inspection by the holders of voting trust certificates for stock of the same class, but only on the written application of five per cent in interest of the holders of all certificates of such class." This provides an ostensible method whereby certificate holders can be reached by persons other than the trustees, so that those concerned may unite for their own self protection.[80]

[77] Bank of America trust agreement, Section 18.

[78] See Chapter VII. [79] Page 17.

[80] Although this provision is a step in the right direction, the question arises why the five percent requirement is included at all. Why require any stated percentage? Further, since it would ordinarily be the small certificate holders who would desire to exercise the right, it would in practice require more than five percent of them—possibly considerably more—to represent a five percent stock interest. And finally, since in these matters it is usually some public-spirited individual or group who takes the initiative in circularizing the certificate holders to induce action, it is first necessary to know whom to address.

The reorganization plan of the United Telephone Electric Company provided for a voting trust that required trustees to permit any certificate holder to examine the list of holders on written notice.[81] From the viewpoint of the certificate holder, this was an improvement over the Consolidation Coal trust agreement.

Future stock issued by the corporation is commonly deposited with the trustees. For example, "In case the Company shall at any time issue any stock or other securities to which the holders of the common stock are entitled to subscribe, the Voting Trustees shall promptly cause notice of such right to subscribe . . . to be given . . . to all the holders of outstanding Trust Certificates . . . ; and the Trust Certificate holders, upon providing the Voting Trustees with funds in the requisite amount, shall have the right . . . to instruct the Voting Trustees to subscribe for such stock . . . or to dispose of the right to receive Trust Certificates representing the stock issuable to the Voting Trustees upon exercise of such right to subscribe. . . . To the extent that any Trust Certificate holder shall fail to exercise such alternative rights the Voting Trustees shall be entitled, in their absolute discretion, to permit such right to subscribe to lapse or to be otherwise disposed of." [82] Other trust agreements are sometimes less detailed in this respect than this quotation indicates, but the effect is the same. If the company is a party to the

How the original list is to be obtained in view of the fact that one of the ultimate purposes is to secure just such a list is a mystery to which there appears to be no solution.

[81] The Securities and Exchange Commission, acting under the Public Utility Holding Company Act of 1935, forced the inclusion of several unusual provisions (relating to a proposed trust) in the reorganization plan. It was provided, in keeping with the Securities and Exchange Act of 1934 (Section 16 b.), that profits realized by any trustee from any purchase and sale, or sale and purchase, of any security of the company within a period of six months would be recoverable (with certain exceptions) by the corporation. Furthermore, it was provided that a trustee might not be an officer or director. (Securities and Exchange Commission, Holding Company Act, Release no. 1187, Aug. 5, 1938.)

[82] American Water Works and Electric Company agreement, p. 13.

agreement, it may agree to deposit with the trustees any additional stock which may be issued.[83]

Another minor provision of most agreements permits the trustees to charge the certificate holders with any taxes which may be levied on the transfer of trust certificates or on the exchange of trust certificates for stock certificates. As a matter of practice, however, the company commonly pays any taxes resulting from the return of the stock to certificate holders.

In order to qualify directions it is sometimes necessary for trustees to transfer to some other person or persons title to a part of the stock held in trust. In such cases, a provision is included in the agreement to this effect. When a director to whom stock has been so transferred is no longer a director, the stock is transferred back to the voting trustees.[84]

The typical voting trust agreement contains some such provision as the following: "The action of a majority of the Voting Trustees, at the time in office, expressed, from time to time, at a meeting or by writing without a meeting, shall, except as otherwise herein stated, constitute the action of the Voting Trustees and have the same effect as if assented to by all. Any Voting Trustee may vote or may act in person or by proxy. At any meeting of the Voting Trustees the presence of a majority of the Voting Trustees, then in office, in person or by proxy shall constitute a quorum. The Voting Trustees may adopt their own rules of procedure. Any Voting Trustee may act as a director or officer of the Corporation, or of any controlled or subsidiary company." [85] To repeat: (1) stock held in the trust shall be voted according to the direction of a majority of the trustees (even though the stock may be held in the name of individual trustees); (2) action may be taken by the trustees with or without a meeting;

[83] See the trust agreements of the Consolidation Coal Company (p. 3) and of the Baldwin Locomotive Works (p. 21).

[84] For a detailed discussion of these provisions, see Cushing, *Voting Trusts*, pp. 116–17.

[85] Sperry Corporation, Article Eighth.

(3) voting trustees may vote by person or by proxy; [86] (4) the voting trustees may adopt their own rules of procedure; and (5) the trustees may act as officers and directors of the Company.

Before closing this chapter mention should be made of several unusual provisions which are, however, of little contemporary importance. On occasion a time limit has been set by the trust agreement on the deposit of stock under it,[87] but at the present time many state laws prohibit this.[88] At least one trust agreement provided that the voting trust certificates should not, for the duration of the trust, be sold separately from the bond to which they were attached.[89]

More interesting than the above are the rare provisions setting up some qualification for the trustees. Thus, it has been provided that the trustees shall be substantial bondholders, or shall give a bond for the proper performance of their duties.[90]

[86] A voting trustee, unless specifically authorized by the trust agreement, may not exercise his rights through another. (Fletcher, *Cyclopedia of the Law of Private Corporations*, 1939 Supplement to Vol. III, p. 25.)

[87] See Cushing, *Voting Trusts*, p. 49.

[88] See Chapter VII.

[89] U.S. House of Representatives, Subcommittee on Investigation of Real Estate Bondholders' Reorganizations. Public hearings, Part 4, p. 1780.

[90] Cushing, *Voting Trusts*, p. 110.

— IV —

USES OF VOTING TRUSTS

THE IMMEDIATE OBJECT of every voting trust is, of course, to place or retain control of a corporation in the hands of certain individuals. But the motives leading to the use of this device for separating control from beneficial ownership cannot be explained so simply. These motives are numerous; some of them are perfectly legitimate while others are less so.[1]

For the purpose of this study, voting trusts may best be classified according to the circumstances leading to their creation. On this basis, four major classes of trusts will be discussed in turn: (1) those resulting from the reorganization of bankrupt or financially weak companies; (2) those created on the promotion of new companies; (3) those established under pressure from public officials; and (4) those set up by the managers of mature and successful corporations.

CORPORATE REORGANIZATIONS

A distinction must here be drawn between two types of financial reorganization; the so-called "voluntary reorganization" or "readjustment" and the involuntary reorganization made under the auspices of a court. Because a voluntary re-

[1] According to a House Committee Report on Real Estate Bondholders' Reorganizations, made in 1936, the voting trust device is only a step "toward the eventual control of the property by insiders . . . so that ultimately the entire property may be acquired by them or their dummies without the investment of a single dollar." Although the Committee probably had in mind the situation as regards real estate reorganizations, this generalization can scarcely be regarded as accurate in covering all cases. (The quotation is from U.S. House of Representatives, Committee on Investigation of Real Estate Bondholders' Reorganization. Supplemental Report, p. 24.)

organization cannot be put into effect without the consent of the stockholders, who will rarely vote for their own complete elimination, the creditor interests often seek a plan which transfers control to themselves while allowing the old stockholders to retain an equity in the property. This object can be accomplished in any of several ways, including the resort to nonvoting common stock. But one of the most popular methods is the creation of a voting trust.

In the past, both the Atchison and the Chesapeake and Ohio railroads were reorganized in this fashion, while more recently we have the example of the Rochester Gas and Electric Corporation (1932). This company was placed under the control of Rochester and New York bankers when it found that it could not redeem its maturing three percent Gold Notes without their aid. The bankers loaned the necessary funds in exchange for a trust agreement which gave them power to appoint a majority of the trustees, these trustees being entitled to elect two-thirds of the directors. The five remaining directors were to be nominated by the holders of the voting trust certificates. Control of the corporation in this case was transferred directly to the commercial banks which supplied the money, and not, as is usually the case, to the investment bankers who sponsor the bond issue necessary to raise the required funds. If, instead of the above arrangement, the note holders had been asked to accept new notes it is fair to assume that the same bankers would have made themselves trustees to protect the interests of their note-holding clients.[2]

The voting trust when associated with an involuntary reorganization, a far more frequent occurrence,[3] must be ex-

[2] This occurred a short time later when the bank loans were repaid by the sale of bonds. The voting trust was continued, and the bankers continued to dominate it.

[3] The following companies constitute representative examples (excluding real estate companies) of involuntary reorganizations in the last few years: Electrol Incorporated, 1936; Baldwin Locomotive Works, 1937; Elk Horn Coal Corp., 1937; Kansas City Public Service Corp., 1936; Consolidated Cement Corp., 1935; The Commonwealth Gas Corp., 1933; Cumberland Gas Corp., 1933; and the Kentucky Ohio Gas Company, 1933.

amined in a different light, for here the stockholders can either be eliminated entirely or given only a modest interest in the new company. The securities of the reorganized corporation can be distributed in any desired manner; voting stock can be given to those security holders who are entitled to control the new company. Thus at least one of the major reasons for the use of the voting trust—the transfer of control from one group to another—has in good part been eliminated.

This does not mean, however, that the voting trust cannot serve a useful purpose in an involuntary reorganization. Control of the corporation can, through the instrumentality of a trust, be placed wherever it is desired, irrespective of the capital structure or of whether the controlling group happens to comprise stockholders or bondholders. This is made clear in the reorganization plan for the Missouri Pacific Railroad Company which was approved by the Interstate Commerce Commission in January, 1940. Three of the voting trustees are to be named by the protective committee for the holders of the Missouri Pacific First and Refunding Mortgage Bonds and the remaining two by the committees representing two other issues of mortgage bonds. On the other hand, the common and preferred stock of the new company is to be given to other bondholders and the general creditors. Though only the preferred stock is to be placed in a trust, practical control in the future is to be lodged with some of the creditors of the old company. It is to be noted, however, that this control is to be exercised not directly, but through the medium of trustees.

A similar rearrangement of control was proposed by the directors of the Chicago, Rock Island and Pacific Railway Company in 1936. Here the reorganization plan provided that all of the bondholders and the common and preferred stockholders should have equal voting power in electing the trustees under a proposed trust. But even though this arrangement may have appealed to the directors as a convenient feature of

the reorganization plan, it was not a necessary part. It should be stressed that when a corporation is involuntarily reorganized a voting trust is not imperative to shift corporate control.

In addition to the problem of the transfer or placing of control, several other reasons for the creation of voting trusts have been suggested. It is often said that regardless of the kind of reorganization which may be in progress, the assurance of good management speeds its completion. Apparently this assertion rests on the belief that a hesitant security holder is able to judge the quality of the future management by the persons to be made trustees,—that is, assuming the trustees are named before the completion of the reorganization, which is not always the case. On this matter, a contributor to the *Harvard Law Review* writes that "complicated financial problems attend corporate reorganizations. Bondholders and creditors are often unwilling to accede to the proposed reorganization plan, nor will new capital be advanced, upon the mere probability that the property will be efficiently managed. By the deposit of a majority of the stock of the embarrassed company with voting trustees, adherence to the scheme is practically assured." [4] And Cushing says that the "certainty of careful management of the stock is often an essential element in securing the acceptance of a reorganization plan by those whose concurrence is indispensible to its success." [5]

Irrespective of whether or not a trust facilitates reorganization, the assurance of efficient management is a worthy aim. The concentration of control and responsibility in one small group of men would probably be stressed by all advocates of the device as a means of attaining this end.

The importance of continuity of management to the reorganized corporation (or any corporation) offers another reason for the use of the voting trust. One trust agreement inferred that repeated change of management was responsible

[4] "Voting Trusts: Their Nature and Validity," *Harvard Law Review*, XL (1926–27), 106.

[5] *Voting Trusts*, p. 14.

for the failure of the company and that a voting trust was necessary to prevent that possibility in the future.[6] Where this is the end in view, a greater permanency of managerial policy is promoted by the use of a voting trust. Continuance of an honest and efficient management undoubtedly helps to improve the company's position. It is equally true, of course, that continuance of poor management cannot but be detrimental to the corporation's future. Such control, moreover, if protected by a trust agreement, would be difficult, if not impossible, to upset.

Another reason or justification for the use of a voting trust is found in the fear that speculators may "move in" and secure control of the company,[7]—a likely possibility because of the low price to which the company's stock may fall, following reorganization. Presumably these speculators, after purchasing sufficient stock to command control, operate the corporation to their own advantage and to the detriment of the other security holders. More realistically, the existing management of a corporation is likely to consider any outsider, who attempts to gain control, a speculative operator. But whether this danger is real or imaginary, the fact remains that many are convinced of its existence. Dewing, in stressing such a danger, points out the ease with which E. H. Harriman secured control of the Southern Pacific Company. At the time, the stock had little market value; and as it was paying no dividends, the successive owners did not bother to have it transferred to their own names. Control over the railroad was secured by the simple method of gradually borrowing the floating supply of stock, having it transferred to the names of persons friendly to Harriman, and then returning the stock to the brokers in the form of "street certificates."

Even though the reasons here cited are of a most general

[6] New York and New England Railroad Company (1892).

[7] Securities and Exchange Commission, *Report on . . . Protective and Reorganization Committees*, Part III, p. 201.

character, they alone can be used to justify the proposed trust of the New York, New Haven and Hartford Railroad Company. The trustees under the Insurance Group Committee's reorganization plan are to be selected by those persons entitled to receive new common stock. Thus the only shift in corporate control is from the stockholders to their representatives—the trustees.[8] No doubt the promoters of the plan would insist that the trust was for the good of all security holders, but presumably the trustees would consider the interests of the certificate holders first.

A new justification for the invocation of this instrument has been put forward in connection with recent real estate reorganizations. A number of individuals were named trustees for several corporations. George Rossetter, a member of the protective committee for the bonds sold by the S. W. Straus and Company of Illinois, is a voting trustee for the stock of at least twenty-three companies; J. C. McCord, a member of the same committee, is a trustee for thirty; Dayton Keith, chairman of a committee engaged in reorganizing companies for which the American Bond and Mortgage Company sold securities, represents twenty-three.[9] It has been argued that this concentration of the control of several properties in the hands of a small group of trustees facilitates centralized management. Men who devote their full time to real estate business are far better able to meet the various problems as they arise since what they learn in one case can be applied elsewhere.[10] This advantage is lessened in the trusts mentioned above, however, by the fact that the properties are scattered over several states.

In his statement before the Securities and Exchange Commission, Dayton Keith testified that the voting trust has been

[8] One-fifth of the directors are to be elected by the preferred stockholders.

[9] Undoubtedly these figures underestimate the extent of the interests of these men, as the figures were secured from Moody's 1939 Real Estate Manual, which does not pretend to include all companies.

[10] Securities and Exchange Commission, *Report*, Part III, p. 200.

used by his committee as an intermediate step in a program to effect the eventual liquidation of the property.[11] He evidently believed that, in addition to the advantages of centralized management preceding the disposition of the property, the trustees could secure a more favorable sale for the security holders. He was unable to name any trust, however, which had been terminated by sale of the corporate property, and there is reason to believe that few of them will be.

As may easily be seen from the following summary, many of the reasons given for the use of voting trusts in corporate reorganizations are equally applicable elsewhere. Voting trusts may be used:

(1) to aid in the transfer of control over a company from one group to another;
(2) to protect the bankers who supply the money for the reorganized corporation;
(3) to assure good management for the corporation and thus aid in completing the reorganization;
(4) to protect the creditors or stockholders or both;
(5) to insure continuity of management until the company can achieve financial stability;
(6) to permit the centralized management of several corporations;
(7) to keep the property from falling into the hands of speculators; and
(8) to aid in the ultimate liquidation of the property.[12]

NEW CORPORATIONS

New corporations, using voting trusts, may be divided into two and possibly three classes: those involving new businesses; the consolidation of old companies; and, in a sense, reincorporated companies. The motivating forces leading to

[11] *Ibid.*

[12] An unusual use of a voting trust in a reorganization is that of the Elk Horn Coal Corporation (1937). Twenty-four percent of the stock of the company was issued to trustees who gave back trust certificates to the company. These certificates were held in the treasury pending their disposal by gift or option to the president and other officers. By the end of 1938 one-half of these certificates had been disposed of to four persons.

the creation of trusts under these varying circumstances differ sufficiently to justify the classification, but it is well to keep in mind similarities as well as differences in the classes.

Besides the general objectives to be obtained from the creation of a voting trust (such as good management) it is said that a new company, which has as yet to establish its inherent earning power, has a special need for continuity of management. A new company needs a strong management to meet the many problems that arise, and the corporation's prospects should not be jeopardized by any division of control.[13] With this principle in mind, let us examine some illustrative cases.

The Pennroad Corporation was organized in 1929 by the management of the Pennsylvania Railroad Company to purchase the securities of other companies desired by the railroad but which it could not directly buy without the consent of the Interstate Commerce Commission. The voting trustees, under the ten-year trust agreement created for the Pennroad, were originally all officers or directors of the Pennsylvania, so that there existed a close but not a legal tie between the two companies. Further, the voting trust certificates of the Pennroad Corporation were initially offered to the stockholders of the Pennsylvania to the amount of $141,285,000, but of this, Kuhn, Loeb and Company received over five million dollars in underwriting fees. Immediately following the incorporation of the Pennroad it began buying for cash the stocks and other securities of a number of companies, including the Canton Company (a real estate company and the owner of a small railroad of interest to the Pennsylvania), the Sea Board Air Line Railway, the Pittsburgh and West Virginia Railway, the Detroit, Toledo and Ironton Railroad, and the New York, New Haven and Hartford Railroad. In most cases it acquired control of the companies, sometimes by the purchase of securities over the organized exchanges and at other times at private sales.

[13] See Dewing, *Financial Policy of Corporations*, p. 394.

In a deal which involved a number of millions of dollars the stock of the Pittsburgh and West Virginia was bought from Frank E. and Charles F. Taplin for one hundred and seventy dollars per share sometime in November, 1929, when the market price of the stock was between 100 and 113.[14] It would seem that the brothers could ill afford not to sell their holdings at such a handsome price, particularly since stock prices had been falling for some time. The purchase of this stock at such a price could only be justified, if at all, by the indirect benefits to accrue to the stockholders of the Pennsylvania, but not to certificate holders of the Pennroad. The purchase at the time was interpreted as a "blow directly at the Van Sweringen brothers," thus indicating the purpose of the company.[15]

The other purchases of the Pennroad, though not in every case so obviously detrimental to the interests of the certificate holders,[16] give added emphasis to the conflicting duties of the voting trustees. The trustees, in keeping with the purpose for which the company was created, represented the interests of the Pennsylvania Railroad, but were at the same time supposed to represent the certificate holders. They could not do both, however, nor could anyone with any sense of realism expect them to do both. Nevertheless, so long as the stockholders of the two companies were the same, it might be argued that this made no difference since what a person lost as a certificate holder he gained as a stockholder of the Pennsyl-

[14] All told, the Pennroad invested $37,910,000 in the stock of this road.

[15] *Financial and Commercial Chronicle,* CXXIX (1929), Part II, 3009.

[16] The prices paid for other securities purchased by the Pennroad were generally at or near the high price for 1929.

Company	Per share	1929 High	1929 Low	1929 earnings	Investment
Canton Company	$611.28	(around 400)		$43.54	$13,500,000
New York, New Haven	122.76	132½	80⅞	11.72	17,302,000
Seaboard Air Line	11.25	21¾	9⅛	0.00	4,524,000
Boston & Maine (Prior pfd.)	114.61	120½	104½		5,077,000

vania. This was the case, no doubt, in 1929, but Joseph B. Eastman of the Interstate Commerce Commission testified that by 1932 there was "no substantial identity of the stockholders of the two companies." [17]

In view of the circumstances leading to the creation of this trust, the investments made by the company, and the losses suffered by the certificate holders, it is not surprising that it has given rise to considerable litigation. The suits, one of which has been tried without result,[18] have asked for invalidation of the trust and an accounting of the operations of the company so that damages may be assessed against the Pennsylvania and the officers and directors of the Pennroad.[19] Although it is impossible to determine with any accuracy the losses suffered by the certificate holders due to the action of the trustees, total losses have been large. Whereas the investments of the company cost $134,993,000 they are now carried on the books at a figure of $47,034,000.[20]

The United Merchants and Manufacturers, Incorporated (formed in October, 1928, to acquire control of textile plants and merchandising organizations) has operated from its inception under a voting trust. It was promoted and has been substantially controlled by Kidder, Peabody and Company [21]

[17] Hearings before the House Committee on Interstate and Foreign Commerce, pursuant to H.R. 9059, 1932. (The same statement is reprinted in a more accessible form in the U.S. Senate, Subcommittee on Interstate Commerce, Investigation of Railroads, Holding Companies, and Affiliated Companies. Hearings pursuant to S. Res. 71, Part 11, p. 4902.) For additional information about the Pennroad in general, see Parts 20 and 21 of the same hearings.

[18] *Perrine* v. *Pennroad* 168 Atl. 196 (1934); 171 Atl. 733 (1934).

[19] The most recent suit against the Pennroad and Pennsylvania was filed June 8, 1940, in the Philadelphia Federal District Court by Mrs. Grace Stein Weigle. (See the New York *Times*, June 10, 1940, Section 3, p. 1.)

[20] Some of these investments have been written down to their current market prices. Others, however, are still carried at cost.

[21] In addition to this venture, Kidder, Peabody and Company sponsored several highly speculative investment trusts during the 1920s, including Kidder Participations, Inc. (1926); Kidder Participations, Inc., No. 2 (1927); and Kidder Participations, Inc., No. 3 (1928).

and Mr. Homer Loring. A good part of the original money for the new company was raised by this banking firm, by the sale of 50,000 units of stock made up of one share of common and one share of six percent Cumulative Preferred stock at \$107.50, while the company sold 250,000 shares of common stock to "persons associated with the management" [22] for \$10 per share. Six months later, in April, 1929, 35,000 shares of six percent Cumulative Preferred, Series "A," were sold to the public at \$100 per share, and 60,000 shares of common stock were offered to the stockholders at \$25—two and one-half times the price paid by the promoters a short time before. In addition to these sales, other stock was offered in exchange for the stock of companies which United Merchants desired to control.

All went well with the company for a short time only. First the company borrowed from banks, then sold notes to pay off the banks, and then sold a second note issue to pay off the first, so that by 1933 the management felt it was necessary to ask the security holders to agree to a "readjustment" of the capital structure of the company. A new ten-year voting trust, with three additional trustees, was created, but the management remained unchanged. Substantially the same directors and officers continued in control. The note holders agreed to an extension of the notes, while the four classes of stockholders agreed to accept in exchange for their shares, in varying proportions, common stock in the new corporation. Each share of both classes of the old preferred stock was exchanged for three shares of the new stock, while each share of the old common got one-half a share of new common. As a consequence of this arrangement we find that: (1) the persons associated with the management who invested \$3,750,000 in the common stock [23] of the company got 150,000

[22] Stock prospectus, October, 1928.

[23] 250,000 common × \$10 + 50,000 common × \$25 = \$3,750,000. (It has been assumed that both groups subscribed to their *pro rata* share of the privileged subscription.)

shares [24] of stock in the new company; while (2) the persons who bought $9,125,000 worth of preferred stock [25] and 60,000 shares of common received 290,000 shares [26] of new common stock. Thus the old promoting stockholders paid $25 per share [27] for the new stock (on the basis of their investment), while the preferred stockholders paid, for the same kind of stock, $32.02, or more than one-fourth again as much.[28]

The outstanding fact which emerges from this somewhat tortuous financial history is that the group which promoted the company and was in charge of its destinies when the difficulties developed, then proceeded to put through a readjustment plan which not only left them in control but made it possible for them to participate on more favorable financial terms than those offered to the other participants. Although it is impossible to say just how much the original voting trust influenced the general course of events, it surely protected the management from attack previous to the readjustment; while the second voting trust (to the creation of which the security holders could only object by refusing to accept the plan of readjustment) assured the continued control of the old management.

The Cliffs Corporation was formed in 1929 by officials of the Cleveland-Cliffs Iron Company to acquire control of this company. The trust certificates of the corporation were offered in exchange for the stock of the iron company, thus avoiding any cash sale of securities. General Theatres Equipment, Incorporated, was a promotion of Pynchon and Company and W. S. Hammond and Company (among others) and

[24] 250,000 common + 50,000 common ÷ ½ = 150,000 shares.

[25] (50,000 units × $107.50) + (35,000 preferred × $100) + (10,000 common × $25) = $9,125,000.

[26] (50,000 preferred × 3) + (35,000 preferred "A" × 3) + (60,000 common × ½) = 285,000 shares of new common.

[27] $3,750,000 ÷ 150,000 shares = $25.

[28] $9,125,000 ÷ 285,000 shares = $32.02.

was also organized in 1929. The banking sponsors here mentioned appointed two of the three trustees named in the trust agreement. The public invested $30,000,000 in trust certificates but were to have no voice in the company's management for a period of ten years. Lastly, the United Retail Chemists Corporation was organized in 1928 by the United Cigar Stores Company of America to acquire control of the Neve Drug Stores, offering trust certificates in exchange for stock of the Neve Drug. In this case the top holding company controlled United Cigar not only through the trustees but also through the ownership of stock.

These cases, although typical of the voting trusts established during the twenties, do little to support the hypothesis with which our examination of actual cases began; namely, that in order to cope with the peculiar problems of youth and growth, a new company needs the strong, centralized, and continuous management made possible by a voting trust. For one thing, the voting trusts of this period were predominantly associated with holding companies. Management was not a serious problem, since it was likely to be supplied either from above, i. e., by the top holding company, as in the case of the United Cigar with United Retail Chemists, or from below, i. e., by the operating companies, as in the case of the Cliffs Corporation. These typical trusts may be regarded as not primarily created to meet a specialized economic need but rather as merely another manifestation of the general speculative spirit of the twenties. Even assuming that new operating companies have a special need for which the voting trust device is the proper solution, the cases described do not appear to belong in this category.[29]

[29] Other companies with voting trusts dating from incorporation, and formed during the twenties, include: Airstocks, Inc., and Aeronautical Industries, Inc., investment trusts; American Commercial Alcohol Corp., General Industrial Alcohol Corp., Cable Electric Products, Inc , Continental Steel Corp., Pittsburgh Utilities Corp. and United Stores Corp., holding companies; and Cable Radio Tube Corp., Consolidated Theatres, Ltd., and Panhandle Eastern Pipe Line Co., industrials.

The use of the voting trust in the consolidations of several old companies has had a long history as we have already seen. In 1928 the Zellerbach Corporation and Crown Williamette, paper companies, were joined together by the Crown Zellerbach Corporation, a holding company engaged in the paper business. The L. C. Smith and Corona Typewriters, Inc., was founded in 1926; a year later the Pennsylvania Glass Sand Corporation resulted from the combination of several other companies. As a rule in these consolidations, voting trust certificates are not sold but are exchanged in varying ratios for the stock of the old companies. The relative ease with which stockholders can be induced to exchange stock for trust certificates, instead of paying cash for them has probably encouraged this use of the voting trust.

The reason for the use of a trust when several firms are combined has been convincingly stated by both Arthur S. Dewing [30] and Harry Cushing.[31] When previously competing firms are joined there is likely to be considerable difference of opinion among the officials (i. e., bankers and the heads of the combining companies) as to the proper policies to be followed. Old jealousies may arise anew to impede the success of the corporation. For example, two of the trustees of the International Harvester Company represented the two largest competitors, while a third represented the bankers who supplied the working capital. The ten trustees of the Crown Zellerbach Corporation must have had numerous conflicting interests and divergent points of view. Under these circumstances the voting trust makes it possible to define and circumscribe the powers and rights of each individual involved; for, if desirable, the agreement may include provisions for the election of officers and directors, and may even specify the policies to be followed by the corporation. It may readily be seen that the trust can be useful although there is no question about the ability of the several men making up the management to con-

[30] *Financial Policy of Corporations*, p. 391 footnote.
[31] *Voting Trusts*, p. 20.

trol the corporation; indeed, it may prove to be a desirable arrangement even if they, as individuals, own the corporation in full.

Only in a legal sense does reincorporation change the status of an old company. For practical purposes a trust created under these circumstances does not fall into the class discussed in this section, but rather, into the miscellaneous group to follow later.

PUBLIC CONTROL

The use of the voting trust for public control, while rare, is of sufficient importance to warrant some attention. The most notable example of a trust to carry out a judicial decree involved an agreement between the Department of Justice of the United States and the New York, New Haven and Hartford Railroad Company in 1914. The railroad and its stockholders agreed to a dissolution decree whereby three voting trusts were created by a Federal court to hold, and later dispose of, certain stockholdings of the company. Under one of the trust agreements the railroad agreed to transfer to five trustees (appointed by, and officers of, the court) its holdings of the stock of the Boston Railroad Holding Company, which, in turn, owned the stock of the Boston and Maine Railroad. Subject to the direction of the court, the trustees were to use their best efforts to sell the stock before January 1, 1917, but it was provided that none should be offered to the stockholders of the New York, New Haven and Hartford. The two remaining trusts that were formed (relating to other subsidiaries of the New Haven) had the same purpose of breaking up the combination, but of the three only one eventually fulfilled its purpose by actually disposing of the securities; the others drifted along for a number of years until the property was returned to the railroad.[82]

[82] Joseph B. Eastman, in his testimony before the House Committee on Interstate and Foreign Commerce in 1932, suggested that the voting trust might again be used to break up certain railroad combinations. His thought seems to have been to deposit some of the stocks owned by such a company

Another way in which the voting trust has been used to effect public control, though not so directly, is exemplified by the trusts of the Brooklyn Rapid Transit and the Interborough Rapid Transit companies. On the reorganization of the Interborough in 1922 the plan provided that trustees under an agreement should elect the directors nominated by the certificate holders, the holders of the First and Refunding Mortgage Bonds, and the Transit Commission of New York. A year later, a trust agreement for the Brooklyn Rapid Transit required that the three trustees elect twelve directors nominated by the trust certificate holders, three nominated by certain bondholders, and three nominated by the Transit Commission.

For our present purpose the important aspect of these agreements is that partial control over the utilities was given to the City of New York. These trusts were simply a device whereby the control could be redistributed among the various security holders and the public authorities; they did not concentrate control in the hands of a few men, as is commonly the case. In keeping with their purpose, the agreement of the Interborough provided that the trust should terminate if a statute was enacted making it possible for the directors to be lawfully elected in the prescribed manner without the aid of a trust. It would be pleasant if all trusts had been created for equally worthy reasons.

SUCCESSFUL CORPORATIONS

In the chapter on the history of voting trusts we mentioned a number of trusts involving one or more companies.[88] These trusts either held the stock of two or three companies, or were concerned with only one stock issue in which several companies were interested. The obvious purpose of the trust

as the Pennroad with trustees, to be voted by them pending their disposal. (On this, see Hearings on Regulation of Railroad Holding Companies, pursuant to H. Res. 9059, p. 266.)

[88] See Chapter II.

formed by E. R. Bacon in 1890 was the joining together of several railroads into a unified system. On the other hand, the stock of the Atlantic and Pacific Railroad (1880) was placed under the control of trustees appointed by the St. Louis and San Francisco and the Atchison, Topeka and Santa Fe railroads so that the Atlantic could be operated for their joint benefit. A trust for the stock of the St. Louis, Kansas City and Northern Railway was formed in 1872 to facilitate the enforcement of a contract relating to the interchange of traffic, entered into by several other roads. The oldest trust still in existence, that of the Mobile and Ohio, falls into this class. A more recent example is the trust of the Fidelity and Columbia Trust Company and the Citizens Union National Bank (1919). The stock of the two banks is held by five trustees so that joint operation of the two banks is assured.

The purpose of these trusts was generally combination, though it might be more accurate to say that some of them only enforced coöperation between competing railroads. But in any event, this use of the device is of little more than historical interest. The holding company and other devices of combination, it is assumed, now fulfill whatever need there once was for the voting trust in this field.[34]

When the owners of a close corporation want to sell their stock and yet retain control, the voting trust proves a convenient device. An interesting example of this is the trust agreement of Armour and Company. The 1922 report of the president to the stockholders said that "in view of Mr. J. Ogden Armour's desire to be relieved of the burden of active management, it was determined that instead of a family owned and managed corporation, it would be preferable if its employees and the public could become the owners of a large portion of the equity of your company. . . . Arrangements were made contemplating the offering of a portion of the com-

[34] No doubt the decline of the voting trust in connection with consolidations was in a good part caused by the antitrust suits, such as the Standard Oil case.

mon stock of your company to its employees and the public for purchase by them in due course, and in order that the purpose of the plan might be carried out in the meantime, Mr. Armour arranged for the deposit of a portion of the common stock of your company held by certain members of the Armour family . . . with voting trustees until the stock could be disposed of. As the stock is sold such voting trust arrangement terminates." However, the trust was not terminated as planned, and three years later a new motive was given for its creation. The voting trust was "originally created for the benefit and protection of the holders of all of the securities of the Company" and "in order to carry out and constitute the purposes and intents of a plan providing for the then pending refinancing of the Company." [85] Regardless of the conclusions which may be drawn from these conflicting statements, the sale of over seventeen million dollars worth of trust certificates to the public by private owners resulted in the liquidation of an investment without any change in control.

The United States Hoffman Machinery Corporation was reincorporated in 1922 to readjust the company's financial plan and to liquidate the investment of its owners. Contrary to the preceding case, however, control was apparently not retained by the persons formerly in command of the company but was transferred to the investment bankers who aided in the refinancing. The Fidelity Securities Corporation and Redmond and Company, sellers of the new securities, controlled two of the three trustees under the agreement, while other bankers disposed of a million dollars' worth of trust certificates for the former owners.[86]

No public offering of trust certificates was made after the reincorporation of the Loose-Wiles Biscuit Company in 1912,

[85] Quoted from the company's application for listing on the New York Stock Exchange, March 10, 1925.

[86] Other companies which incorporated or reincorporated and sold trust certificates for cash include: Iron Fireman Manufacturing Co. (1928); Raytheon Manufacturing Co. (1928); and Schletter and Zander, Inc. (1929).

but the certificates were listed on the New York Stock Exchange, and it is presumed that large owners were gradually able to dispose of their holdings. A partner of William Solomon and Company, seller of preferred stock for the company, was made one of the three trustees, while the other two trustees are believed to have represented the former owners. The Cream of Wheat Corporation was "sold" to the public in 1929 without any change in management. The owners and managers of the old company became the officers and trustees of the present corporation even though several bankers participated in the sale of trust certificates. However, two of the directors of the new company represented the banking interests. These trust certificates were sold, not by the company, but by individuals only a short time after the reincorporation.

In October, 1928, a syndicate was formed for the purpose of readjusting the capital structure of the Bellanca Aircraft Corporation. The syndicate agreed to purchase 104,000 shares of common stock (voting trust certificates) for $1,625,000 and to take an option to purchase 25,000 additional shares at $20 per share. Up to this time G. M. Bellanca had retained voting control of the company, but as a consequence of the recapitalization he agreed to turn over to the trustees his own stock along with the stock bought by the syndicate, under a five-year voting trust agreement.[37]

The general pattern of the preceding trusts is as follows: an old company is reincorporated; a trust is created for the common stock with the old owner-management and bankers as trustees; some new securities are sold to the public by the corporation in addition to the trust certificates sold by individual owners; and as a result, the company is now owned by the public and controlled by the former owners, or by the bankers. Of course a trust of this type may lay claim to the general virtues of all trusts, but its existence cannot be justified on the basis of any special need. Perpetuation of control

[37] See *Chandler* v. *Bellanca Aircraft Corp.* 162 Atl. 63 (1932).

by former owners (or transfer of control to, or division with, bankers) is the only specific reason for its creation.

When a voting trust is created preceding the sale of bonds it is sometimes difficult to tell whether the company is experiencing a voluntary reorganization or merely raising capital. It is probable, however, that when bankers are given partial or complete control over the corporation through a voting trust, the former control is under some pressure to secure funds. On the other hand, the management may only be using the sale of bonds as an occasion to increase its own power, though the importance or even the existence of this element cannot be determined in any particular case. The bankers who sold the bonds and other securities for the United States Hoffman Corporation apparently demanded and secured almost complete control in connection with the refinancing. Halsey Stuart and Company assumed control over the Consumers Company in 1926 by means of a trust which was to terminate on the redemption of bonds payable in twenty years. By contrast, the ten-year trust of the United Electric Coal Companies (1925) did not seriously disturb the existing control. In exchange for the sale of ten-year bonds, Hemphill, Noyes and Company appointed only one of the three trustees.

On the whole the purpose of these trusts is similar to those resulting from reorganizations. One writer goes so far as to say that without the voting trust "it would be practically impossible for a corporation to secure financial assistance when it was most needed, because in large financial loans, the loaning party would insist on stable management, which can only be secured by the knowledge that a majority of the stockholders will continue a management approved by those who have financial interests at stake." [38] However, it is important to note that here, as elsewhere, it is the bankers who are made trustees, and not those security holders who have a direct financial interest in the success of the company.

[38] Max W. Heck, in *Marquette Law Review*, III (1919), 168.

Examples of the use of the voting trust to facilitate the sale of the stock or the assets of a corporation are numerous. It has already been mentioned that the stock of the International-Great Northern was sold by the trustees in 1924, and other railroads and industrials might be similarly mentioned.[39] During the 1920s this use was extended to the public utility companies which were rapidly being consolidated into large systems by means of the holding company device. Dewing writes that in many of these operating utilities

> no single individual or interest held either a large stock interest or an operating control, while in other instances a strong operating control was exercised by a group of men who owned a comparatively small minority of the stock. Those in control of the corporation feared that an outside holding company would quietly acquire the scattered stockholdings from individual stockholders who were unfamiliar with the high prices being paid for the actual stock control of operating companies. Should this be done, the remaining outstanding minority stock would have substantially less value than it did before a majority had been corralled. To avoid this contingency and to present a solid front to any prospective buyer, the directors, familiar with the actual conditions, would invite all stockholders to deposit their stock in a voting trust. The voting trust provided, specifically, that the control would not be sold at less than a specified price—usually outrageously high—and that the contract sale price at which the majority was sold would be offered to the undeposited minority. In this way, under the lure of getting an extravagant price for their shares, the scattered stockholders secured to the management a continuation of its operating control.[40]

The controlling stock of the Blackston Valley Gas and Electric Company, the Worcester Electric Light Company, and the Fall River Electric Light Company was actually disposed of by the trustees. The trustees under the Blackston agreement of 1927 were given the right to sell the preferred stock for $115 per share and the common for not less than

[39] See Cushing, *Voting Trusts*, pp. 94–97.
[40] *Financial Policy of Corporations*, pp. 391–92.

$200, but apparently such a sale could not be arranged and so the certificate holders a year later agreed to exchange their certificates for the stock of the Eastern Utilities Associates. The generosity of the offer may perhaps be judged from the fact that over four-fifths of the stock was exchanged within a few months.

The Fall River trust was terminated by the cash sale of stock in 1929, two years after its formation. The 1927 trust of the Worcester Electric Light ended in 1929 when its stock was sold to the New England Power Associates for $226 per share, one dollar more than was provided for in the trust agreement. The Brockton Gas trust of the same year, however, did not end so successfully. This agreement provided that the stock should not be sold for less than $100 a share, while its highest quotation in 1929 was only $56. Not until 1931, two months before the expiration of the agreement, was the trust ended by the trustees. Equally unfruitful trusts were those of the North Boston Lighting Properties (1927) and the Rockland Light and Power Company (1927).

The use of the voting trust by close corporations is exemplified by a trust created to protect an estate. Several years prior to the death of D. W. Alderman, Sr., who owned practically all of the stock of the D. W. Alderman Railroad Company, his holdings were divided equally among his six children. In order, however, to assure the control of the two sons who had for some time managed the property, a voting trust, to be terminated on the death of the last survivor, was created. It was hoped that by this device the property might be well managed.[41]

[41] In a suit to invalidate this trust several of the children claimed that the trustees (their brothers) had paid themselves excessive salaries and mismanaged the corporation's funds. But the court held that the trustees, even though they bought bank stocks with the corporate funds when the corporation did not have that power, were not liable because they had acted in good faith and with the tacit consent of their brothers and sisters. Likewise, the court did not believe the salaries paid to the trustees were excessive. (*Alderman* v. *Alderman*, 181 SE 897 (1935).

It cannot be said that the use of the trust to insure control forms a class very sharply separated from the other uses. The distinguishing characteristic of this group is mainly that the promotors of these trusts are interested in the maintenance of an existing control and are not planning to risk its alienation by liquidating their stock holdings or borrowing money by the sale of bonds.

An excellent example of this use is found in the trust of the Missouri State Life Insurance Company (1931) which was created to prevent a threatened change of management. Although twenty-nine percent of the stock of this company was indirectly owned by the Keystone Holding Company, control was exercised by a different group of men who apparently had only small stock holdings. An effort on the part of the holding company to dislodge the then existing management precipitated a proxy fight and the management formed a voting trust as a means of holding control. Eventually a compromise was effected by the terms of which a Federal judge was appointed president; but, in spite of this partial defeat, the trust undoubtedly strengthened the bargaining position of the management.[42]

More commonly, voting trusts are created when there is no immediate threat to the existing control, and at times even by majority stockholders. The Virginian Railway trust was formed by the founder of the company and his associates who owned a substantial majority of the voting stock. Similar circumstances probably existed with respect to the Bankers Trust and the Guaranty Trust companies of New York, as their stock was not publicly held. As a matter of fact, even the existence of these three trusts was, as we shall see later, not generally known.

Dewing [43] ascribes the creation of many trusts of this type to "personal or business ambition or jealousy." Because the

[42] A short time later the company was reorganized with a new voting trust.
[43] *Financial Policy of Corporations*, p. 390.

companies are too large for one man to own sufficient stock to command control, a number of men band together in order to protect themselves as a group and also from one another. By this device the relative position of the individuals may be fixed, and the possibility of dispute minimized.

The ten-year trust of the Public Investing Company (a small investment trust), dated 1936, was created when the company could not have been in any financial difficulty as it had nothing but common stock outstanding. The company was promoted by Frederick Peirce and Company in 1929, who retained control both before and after the formation of the trust. In contrast to the preceding examples, the control owned less than one-half of one percent of the stock, but was nevertheless able to secure the deposit of a majority of the shares under a trust agreement. Whatever reason may have been given for the creation of this trust, it is evident that the result was to strengthen an existing control without changing anything else.

CONCLUSIONS

We have found that voting trusts have been used by corporations—old, new, and bankrupt—for a variety of proximate purposes.[44] Various explanations have been given for placing the control over the stock of a particular corporation in certain hands; sometimes to protect specified bondholders, and at other times "for the good of all the security holders." But whether the trust results from the reorganization of a large corporation, or from an agreement of the stockholders

[44] Previously unmentioned was the 1939 trust of the underwriting firm of Brown, Harriman and Company, later Harriman, Ripley and Company, Inc. It was suggested at the hearings before the Temporary National Economic Committee that this trust was created to tie the company to the banking house of Brown Brothers, Harriman and Company in contravention of the Banking Act of 1933 separating banks from their affiliates. Thus the two companies were independent only in "legal fiction." (Temporary National Economic Committee, *Proceedings*, X, 13.)

of a small company, it is control that is at stake. Thus, the fundamental purpose of every voting trust is either to transfer the control from one group to another, or to perpetuate the existing control.

— V —

VOTING TRUSTEES

BEFORE ANY CONCLUSIONS can be reached concerning the desirability of the voting trust, it is necessary to know something about the trustees; i. e., what their financial interests are and whom they represent. We want to know the amount of their stockholdings, and also their relation to the officers and directors of the corporation, to reorganization managers, competitors, bankers, and creditors. If the trustees own no common stock, we want to know if they own any other securities which might make for conflicting interests. In short, do the trustees have interests different from the interests of the persons whom they are supposed to represent? If so, how can they be expected to protect the interests of their constituents? It is the purpose of this chapter, so far as possible, to answer these questions.

Far more often than not the voting trustees are also officers and directors of the corporation; usually, all of them are directors and two of them are officers. To mention only a few of the possible examples, this was the case in the trusts of the Kentucky Ohio Gas Company, Creameries of America, Compo Shoe Machinery, Commonwealth Gas, Columbian Carbon, Columbia Pictures, American Water Works and Electric, and Cable Electric Products. The president and vice president of the Cleveland-Cliffs Iron Company, controlled by the Cliffs Corporation, were trustees of the holding company.

When this situation exists it is readily seen that control by the trustees is not superimposed upon the management of

the usual corporate officials, since the officers, directors and trustees are the same men. The trustees do not form an independent body apart from the officials of the corporation; they are one and the same. If two out of three trustees are officers, the board of directors normally has only a nominal existence. Where formerly there were three "levels of management"—the stockholders, the directors, and the officers—the voting trust makes for one. All three levels of management are placed in the hands of two or three men whose actions are left unreviewed by any independent body. Thus a system of divided powers is abandoned for a corporate dictatorship.

Although this is the result that generally obtains, there are, of course, occasional exceptions. The trustees for the Missouri Pacific Railroad [1] and the Baldwin Locomotive Works were neither officers nor directors of their respective companies, and only one trustee was a director of the Central Public Utility Corporation. Two of the five trustees of the Consolidation Coal Company were directors; while two of the three trustees of Bellanca Aircraft were officers and directors. Under these circumstances, assuming the board of directors to be made up of men willing and able to exercise judgment, there may be some division of power; the officers may manage the corporation in its day-to-day business, while the directors pass on their actions; and the trustees elect the directors and otherwise fulfill the duties of stockholders. This could and undoubtedly did happen in some cases, but the likelihood hardly warrants any extended examination. By and large it remains true that as a rule the officers, directors, and trustees of a corporation are substantially the same men.

REORGANIZATION COMMITTEES

The voting trustees for a reorganized corporation are usually selected by the reorganization committee (or protective

[1] In this case the provisions of the Clayton Act of 1914 were responsible. For a discussion of how the matter was worked out in practice, see pp. 15, 81.

committees) and "very frequently" the committee names its own members.[2] The most extensive evidence of this is found in the real estate reorganizations of recent years. For example, the Securities and Exchange Commission found that out of ten trusts created by two committees engaged in reorganizing companies for which the American Bond and Mortgage Company sold bonds, thirty-one of the thirty-two trustees were members of the committees. Similarly, of the seventy-six reorganization plans formulated by the Straus company committee, all except one designated one or more persons who were affiliated with the Straus company or were chosen by the committees as trustee.[3]

Since the reorganization committee chooses the trustees, the question arises as to who controls the committee; the answer is simple: usually the bankers (the house of issue for the company's securities), the management of the corporation, and the counsel for either or both of the foregoing. Ordinarily this group will control the whole reorganization, including the appointment of a receiver, unless the judge has an appointee favorite of his own.[4] Thus, even though it may have been partly responsible for the company's failure, the old management is often in control both during the reorganization and after by the appointment of voting trustees. The bondholders and other creditors, having little or no control over the selection or the actions of the voting trustees, benefit from the trust only in so far as the trustees may represent, and protect, their interests. Occasionally, however, an "independent" protective committee, after gaining control over the reorganization, will appoint some of the trustees. In the reorganization of the Baldwin Locomotive Works Mr. Bernhard, an investment counsel and chairman of the independent bondholders

[2] Securities and Exchange Commission, *Report on . . . Protective and Reorganization Committees*, Part I, p. 152.

[3] *Ibid.*, Part III, pp. 198–99.

[4] House of Representatives, Investigation of Real Estate Bondholder's Reorganizations. Supplemental Report, p. 13.

protective committee, was selected as one of the five trustees.[5]

Whenever the trustees are appointed by one group of interests to represent the interests of a second group—as is commonly the case—there is always the possibility that the appointees will be most concerned with the financial welfare of the persons who put them into power. Even if the trustees have not previously been directly associated with the management or the bankers it is nevertheless through their influence that they become trustees, and it is to those groups that they must look for future patronage. This conflict of interests becomes a full-fledged reality when, for example, the old stockholders are given new common stock and the creditors are given bonds or preferred stock. The trustees have two opposing obligations—a legal and moral obligation to the senior security holders, and a "moral" debt to the persons who controlled the reorganization. Under these circumstances the voting trustees might, for example, refuse to declare a justifiable dividend on the preferred stock, or, again, they might pay such large dividends on the common stock as to endanger the creditors. Undoubtedly there are many ways in which conflicts may arise; so many, in fact, that the creditor's only hope of protection lies in the integrity and good judgment of the trustees. But even good intentions and judgment may not be enough, for the difficulties of serving two masters at the same time are not easily solved, if at all.[6]

TRUSTEES AND COMPETITORS

Although, as we have seen, the voting trust has been used to effect monopolies, we are here concerned only with the problem of conflicting interests. If one man is a trustee for

[5] Securities and Exchange Commission, *Report*, Part I, p 838.

[6] For a sympathetic discussion of the selection of trustees see Cushing, *Voting Trusts*, pp. 101–2. The reader interested in the technical details of the formation of protective committees or reorganization committees may be referred to Lyon, *Corporations and Their Financing*, Chapter XLI, or to any other good text book on the subject.

two or more competing companies, even if the question of monopoly is not involved, is it not more than possible that situations will arise in which he will have to favor one firm over another, irrespective of his ethical qualifications and characteristics? For example, J. P. Morgan was, in the ten year period following 1886, a trustee for six different railroads, some of which were competitors; and, recently, one of the voting trustees of the United Merchants and Manufacturers was also a trustee for four other competing companies. Although the importance of this problem should not be exaggerated, since the same difficulties arise in connection with interlocking directorates on a far larger scale, it is not unreasonable to require the trustees to notify the certificate holders of their outside interests. Of course some certificate holders may consider any lessening of competition as an advantage, but they are nevertheless entitled to know of the varied financial interests of the trustees—something which was seldom the case before the passage of the Securities and Exchange acts.

BANKERS AS VOTING TRUSTEES

Whatever may be the reason for the creation of the voting trust, bankers are commonly represented among the trustees. Though reference has already been made to this fact several times it is appropriate here to enumerate some of these trusts. A majority of the trustees of the following companies were selected by banking interests: American Utilities Service Corporation (1935–); Sulzberger and Sons (1915–1920); Consumers Company (1926–); General Theatres Equipment (1929–1936); Public Investing (1936–); and the Universal Corporation (1936–). One or more of the trustees for Central Atlantic States Service (1928–1934), United Electric Coal (1925–1935), Electric Finance (1924–1929), American Sumatra Tobacco (1926–1927), Columbia Pictures (1930–1940), Pennsylvania Glass Sand (1927–).

and Consolidation Coal (1935–1940) were also bankers. This list is of necessity incomplete as, until recently, it was often impossible to ascertain whether or not a particular trustee represented banker interests unless he was directly associated therewith or unless the trust agreement indicated the fact.[7] Since the Securities and Exchange acts were passed, however, this information has been available in the case of registered securities.

Assuming the undeniable fact that bankers are responsible for and control a good share of the voting trusts, how may their interests differ from those of the trust certificate holders? As we shall see a little later the trustees seldom own substantial amounts of the corporation's securities, nor, except on rare occasions, are the banking firms with which they are associated direct creditors.[8] There is no reason to assume, therefore, that the interests of the corporation and those of the trustees are necessarily the same. With these facts in mind, let us examine some of the possibilities.

The Public Investing Company, a small investment trust, is controlled by Frederick Peirce and Company, who originally promoted it. For a fee, Peirce and Company provides the trust with office space, insurance, and clerical service;

[7] As indicative of the difficulty of determining whether or not any particular official of a company represents banking interests see, in connection with the Missouri Pacific Railroad, the testimony offered before a hearing of a Subcommittee of the U.S. Senate Committee on Interstate Commerce on November 4, 1937 printed in Part 13 (Investigation of Railroad Holding Companies, and Affiliated Companies. Hearings pursuant to S. Res. 71, pp. 5592–5618.) During these hearings, a partner of Kuhn, Loeb and Company —who were the bankers for Missouri Pacific—was questioned concerning the relationship of that company with the Chairmanship of the Board of the railroad, a Mr. Williams. It was noted that Mr. Williams had also at various times served in official capacities on three other railroads, for which Kuhn, Loeb and Co. were also bankers. The question was then asked: "Was Mr. Williams, in one way or another, in business relationship with Kuhn, Loeb and Co."? To this the banker noncommittally replied: "He has been an official of companies for which we have acted as bankers" (*Ibid.*, p. 5613).

[8] A trustee for both the Columbia Pictures Corporation and the Universal Corporation is a director of the Bank of America National Trust and Saving Association, an occasional lender to both companies.

and, at least until 1946, it can continue to receive this business because of the existence of a voting trust. Considering these facts, what is to prevent or discourage the banking house from charging whatever it pleases for its services? It might of course still make exorbitant charges without a voting trust but there would then always be a possibility that control might change hands. Prior to the passage of the Investment Company Act of 1940, which gave the Securities and Exchange Commission power to regulate investment companies and investment advisors, there was little to prevent bankers from selling to an investment trust securities which they found difficult to dispose of otherwise. In view of the large number of companies which may have been exploited in this way during the twenties, Section 17 of the act was well justified.

A third possible way in which a company can be manipulated by the voting trustees to their advantage exists in practically every voting trust. Samuel Untermyer brought out, in the 1913 Money Trust Investigation, that J. P. Morgan was in effect dealing with himself when the Morgan company sold Southern Railway securities, as Morgan was a trustee of the railway. There is nothing unusual about this. Whether control (partial or complete) is exercised by means of a voting trust or not, the interested bankers assume the right to sell the corporation's securities. Although the practice is admittedly fairly common, this does not mean that it is one which should be permitted, let alone encouraged.

This enumeration of possible sources of profit to the banker-trustees is not intended to be all-inclusive, but only to indicate some of the hazards to which the certificate holder is subjected. However, control over a corporation by any group, bankers or others, can be made profitable to the controlling group and detrimental to the investors. The reason for here identifying manipulation with banker management, to the exclusion of other types of control, is that this is the situation most frequently encountered.

So far as manipulation is concerned, the voting trust is important only because it strengthens the position of the controlling group. The interests of the certificate holders (or bondholders) can be disregarded with impunity and without fear of loss of control, so long as no one is given cause for legal action. Of course, suits can be instituted by the security holders to protect their interests, but the question may be raised as to just how much, in practice, this theoretical right is really worth.[9]

SECURITY HOLDINGS OF TRUSTEES

The voting trustees commonly own few or none of the securities they are supposed to protect; while even worse, their holdings may produce conflicting interests. But first let us examine some typical examples. Less than one-half of one percent of the stock (trust certificates) of the Public Investing Company was owned by the trustees; none by the trustees of the United Stores Corporation; while the prospectus for the trust certificates of the Stuart Court Property Corporation provides that "No Voting Trustee now has or proposes to acquire a beneficial interest in the securities subject or to be subject to the Voting Trust Agreement," but may do so if he desires. A significant amount of stock was owned by the trustees for the following companies: Cream of Wheat (6 percent in 1935); Columbian Carbon (3 percent to 6 percent in 1935); American Seating and Gold Dust. As exceptions to the general rule that trustees seldom own much stock, they own 25 percent of the stock of Cable Electric (a very small company), 40 percent of the stock of Columbia Pictures (1938), and 20 percent of the stock of Bellanca Aircraft (1937). An exceptionally large amount of stock was owned

[9] With reference to this general situation Maurice Mound, of the New York Bar, has said, "Human lethargy, prohibitive expense, lack of organization among [security holders], and reluctance of the courts to interfere with the internal management of a corporation—all contribute to keep the great mass of such claims out of the courts." (From Bonbright and Means, *The Holding Company*, p. 344.)

by the trustees of the Pennsylvania Glass Sand (73 percent in 1935); and of the stock of the large Cliffs Corporation (1935), 11 percent was owned by the trustees.[10]

The House of Representatives committee investigating real estate reorganizations found that voting trustees "rarely, if ever, own any bonds" of the defaulting corporation.[11] And Dayton Keith, chairman of a committee reorganizing 169 corporations (and a voting trustee of many of them), testified that he did not own a single bond when he became a member of the committee.[12]

The prevalence of this situation does not speak well for the voting trust. When, for example, a trustee owns only 160 shares of stock in a corporation having over 500,000 shares outstanding (as in the case of Columbian Carbon), it cannot be expected that his investment determines his interests. If the trustee does not have a substantial investment in the corporation, it is important to know who pays him for his services. And if he is not paid by the corporation as a trustee or officer, or by a banking house, does he have undisclosed interests? Obviously, it is seldom that an outsider can answer these questions concerning any particular trustee, but this does not mean that they are unimportant to the security holder who is presumably protected by the voting trust.

Too often the trustees not only own none of the securities they are supposed to represent, but own other securities with actually or potentially conflicting interests. The reorganization agreement of the Baldwin Locomotive Works provided for the appointment of three men as trustees to represent the holders of the Consolidated Mortgage Bonds. Two of these men owned no bonds; while the third, Arnold Bernhard, was an investment counsel and the head of a bondholders committee made up mostly of his own clients. "Prior to his com-

[10] Trustee stockholdings here cited have been secured from several sources: prospectuses, newspaper reports, and the reports of the Securities and Exchange Commission.

[11] Supplemental Report, p. 11. [12] *Ibid.*, p. 116.

mittee's approval of the reorganization plan on August 7, 1935, and before the formation of the trust," says the Securities and Exchange Commission's report,[13] "while negotiations still were going on, and presumably on the basis of Mr. Bernhard's advice, 15 of his clients (including 3 committee members other than himself) made purchases of preferred stock." In justifying this advice before the Securities and Exchange Commission, he stated that he considered the preferred stock a good purchase provided "it were to receive fair treatment."

"Two things are apparent here," the report continues. "In the first place, Mr. Bernhard's recommendations prior to the plan were made on the basis of inside information concerning the plan which came to him in his fiduciary capacity. In the second place, his recommendations of the preferred stock might well imply a duty on his part to see that the stock was 'fairly' treated in the plan, a duty which might not be compatible with his duty to consolidated bondholders." [14] But Arnold Bernhard's conflicting interests and duties did not stop here, for during 1938 and 1939 he bought and sold substantial amounts of convertible bonds, preferred stock, and voting trust certificates. At various times during this period he owned as much as one hundred and fifty-four shares of preferred stock, twenty-two thousand dollars' worth of bonds and eight hundred shares of certificates. Even though these holdings were probably not large enough exclusively to determine his actions, they surely must have had some influence; and it is patent that what was good for one class of security was not necessarily good for the others.

In 1928, Halsey, Stuart and Company and Hambleton and Company were interested in the promotion of the Wardman Realty and Construction Company which in turn owned the stock of the Wardman Real Estate Properties, Incorporated

[13] Securities and Exchange Commission, *Report*, Part I, p. 847.
[14] *Ibid.*, p. 848.

(owner of eleven Washington properties). All told, some twenty-three million dollars' worth of bonds were issued. When interest on the various bond issues could not be met, the bankers formed a protective committee made up of persons connected with or selected by them. In 1932 the Wardman Real Estate Properties was reorganized as Washington Properties, Incorporated; and of the three voting trustees selected for the new corporation, two were appointed by Halsey Stuart to represent the mortgage bonds, and one by Hambleton on behalf of the debentures. The interesting aspect of this case is that within two years after the reorganization Halsey Stuart owned eleven percent of the trust certificates of this $15,000,000 corporation, in spite of the fact that the trustees selected by them were supposed to represent the bondholders.[15]

Under these circumstances, will the trustees represent the interests of the bondholders, or Halsey, Stuart and Company? It is a safe conclusion that they would hesitate to act contrary to the interests of the certificate holders.

One may wonder why security holders are so seldom made voting trustees, since that would seem to be the logical procedure. For real estate reorganizations of recent years, Dayton Keith testified that sometimes this is done, but that "it depends largely on whether there is any one individual bondholder who is large enough to represent a certain group. Mostly they are scattered from coast to coast, holding one bond. The average holding of bonds is less than a thousand dollars per man." [16] Assuming the accuracy of his statements, this may be an explanation of why the security holders of real estate companies have not been made trustees, but it is doubtful if it can be applied to other reorganizations.

[15] See the public hearings before the House of Representatives, Subcommittee on Investigation of Real Estate Bondholders' Reorganizations. Public Hearings, Part 4.

[16] *Ibid.*, Part 1, p. 116.

— VI —

SECURITY HOLDERS UNDER A VOTING TRUST

In creating new trusts or extending old ones, several methods have been used to force the deposit of stock with trustees. Most commonly, such a procedure is necessary only on the extension of a trust, but when a new trust does not involve the incorporation or reincorporation of a company, the question of deposits arises immediately.

Before examining the methods, let us inquire into the success attained by some trustees in securing deposits so that we may have a better idea of the magnitude of the problem facing them. At times only a bare majority of the stock is held in trust, as in the case of the United Cigar Manufacturing Company and of the Public Investing Company. In the Loose-Wiles case, on the other hand, although all of the stock was held by the trustees, the trust was twice extended. Here, presumably, nonassenting certificate holders were not permitted to withdraw their stock from the trust after a majority had agreed to its extension. The Universal Corporation is an unusual case in that, in contrast to customary procedure with a new company, only part of its stock is held by the trustees, although the trust was created on its incorporation. All of the stock of the Rio Grande Valley Gas was held in trust from the company's inception until 1937, but when the trust was extended for another ten year period only eighty percent of the stock was deposited. The trust of the L. C. Smith and Corona Typewriters, created and extended under similar cir-

cumstances, recently held ninety-eight percent of the stock. Quite often only a few shares of stock will not be held in trust, but this is commonly the result of the necessity of qualifying directors. Thus the five shares of the stock of the Pennsylvania Glass Sand, not held by the trustees, were presumably "owned" by the directors.

Of the several ways in which stockholders are encouraged, or forced, to deposit their stock, by far the most important is the listing of the trust certificates on an exchange while leaving the stock to fare for itself in the over-the-counter market. The frequency with which this occurs is evidenced by the trusts of Gorham Manufacturing, Rio Grande Valley Gas, L. C. Smith and Corona, Columbia Pictures, Cable Electric Products, and American Commercial Alcohol, all of which have had trust certificates listed either on the Curb Exchange or the New York Stock Exchange.

Harry Cushing contends, in effect, that the stockholder who does not desire to deposit is little harmed by this situation, though he concedes that the unlisted securities are not "so fully available for use as collateral as are listed securities." However, he continues, "the alleged discrimination, if such it is, may easily be given an exaggerated importance, because such a minority stockholder . . . if he really wishes a loan might readily convert his certificate into a more acceptable form of collateral." [1] Likewise, when a stockholder wishes to sell his undeposited securities it must be admitted that he can easily (except in rare cases) exchange his stock for trust certificates; and unless he wishes to repurchase the stock later, the exchange probably will make no difference to him. Thus, of necessity, we are led to the conclusion that, except under relatively unusual circumstances, no stockholder is forced to deposit his stock with voting trustees, unless he so desires. So long as he does not want to borrow on the stock, or sell it, he can with impunity refuse to deposit; and even

[1] *Voting Trusts*, pp. 91–92.

when he desires to do either, he *usually* may do so without harm to himself.

But in spite of this consideration, the listing of trust certificates on a stock exchange does appear to encourage the deposit of stock. Rightly or wrongly, stockholders appear to be influenced by the argument that it is to their advantage to deposit their stock and secure the blessings of an organized market. Trustees commonly mention to the stockholders (or certificate holders), when promoting the creation or extension of a trust, that the certificates are to be listed; while a letter to the stockholders of Compo Shoe Machinery went even further and stressed the fact that only the certificates would be so listed. As indicative of the pressure, real or apparent, which can be placed on the stockholder, the extension of the Loose-Wiles Biscuit trust is interesting. Some eighteen days before the expiration of the trust in 1922, the trustees made application to the New York Stock Exchange for the listing of the certificates, though only twenty percent of the stockholders had assented to the extension at that time. In effect, the stockholders were told that unless they wanted to be the owners of unlisted securities they must accept trust certificates. Of course they could have refused the request, but, as a matter of fact, at least a majority of them did not; and it appears that even those who did not assent to the extension were not permitted to reobtain their stock.[2]

Two exceptions to the rule that trust certificates are listed to the exclusion of the related stock are found in the trusts of the American Water Works and Electric Company and the United Cigar Manufactures Company. In the latter case,

[2] Reorganization committees use similar methods, the Securities and Exchange Commission found. Thus, "Another method designed to make deposit with a committee desirable is to list the committee's certificates of deposit upon a securities exchange and then to take steps to have the security itself delisted. If the underlying security is stricken or suspended by the exchange, the consequence will be a preferable market for the certificates of deposit. To obtain the benefits of that market, security holders must deposit." (*Report . . . on Protective and Reorganization Committees*, Part I, p. 530.)

however, the expiration of the trust a few months after the stock was listed on the New York Stock Exchange eliminated the trust certificates.

What might be called a second way to encourage the deposit of stock may be exemplified by the letter [3] sent to the certificate holders of Loose-Wiles in 1917. The trustees said they desired an extension of the trust because of the problems created by the war; such problems were "principally due to the high cost of flour, lard and other raw materials." Though it is difficult to understand why this should necessitate the extension of the trust, the point to be made here is that trustees probably without exception make some effort to justify their actions. The prospective depositor is made to feel that the trust is to his advantage and that he will suffer if he does not deposit his stock. Although this effort at persuasion cannot be said to force the stockholders to take action against his will, it is commonly effective, and should, therefore, be observed.

A third way in which pressure is exerted on the stockholder is to limit the time during which he may deposit. The following remarks of the Securities and Exchange Commission are pertinent in this respect even though they refer to reorganization committees: "A well accepted practice designed by committees to drive in deposits is to set a relatively short period for deposit, thus creating the impression that immediate action is necessary in order to participate in the plan or to share the benefits of the committee's activity. The periods are then extended from time to time, while, in turn, creating the impression that each extension will be the last." [4] As Cushing has pointed out this procedure has been used in the past in connection with voting trusts, but, as we shall see in the following chapter, it is now prohibited by many state laws and frowned upon by some courts.[5] Nevertheless, whenever

[3] Dated April 14, 1917.
[4] *Report*, Part I, p. 530.
[5] See Cushing, *Voting Trusts*, pp. 171–72.

this method can be used in connection with the listing of the securities on an exchange, the stockholder may feel that he has no choice but to deposit; for by acting otherwise, he may be indefinitely deprived of an organized market.

A fourth method of inducing deposit is exemplified by the previously mentioned case of the Southern Railway Company in which the trustees threatened not to pay dividends—an event which would terminate the trust—unless the certificate holders accepted an extension. In this situation, the certificate holder had practically no choice. If he refused to grant the extension the dividend would not be paid and he would not get his stock; while if he agreed, he at least got a dividend. At the present time, however, so few trusts are terminated in this fashion that little discussion of the point is now warranted; but contemporary railroad reorganizations, and their resulting trusts, may again make this type of pressure possible.[6]

ACCESS TO LIST OF CERTIFICATE HOLDERS

At times it is important to the certificate holder to be able to communicate with his fellow security holders. Such an occasion may arise when the trustees are attempting to extend the trust; or it may arise if the trust agreement permits termination of the trust by the certificate holders and if some of them wish to exercise this right. In either event, they must get together in order to protect themselves from the trustees,

[6] A roundabout attempt was made to extend the 1929 trust of the Silver Rod Stores without the consent of the certificate holders. In 1934 the trustees decided to form a subsidiary company to take over the bulk of the assets of the Silver Rod in exchange for the stock of the former company. But a few weeks later a ten year trust was created for the subsidiary to perpetuate the control of the trustees after the termination of the original trust, and trust certificates were delivered to the parent company instead of stock. The practical result of these transactions was to extend the life of the original trust, for even after its termination the trustees could control the subsidiary under the second trust. The parent would thus be but an empty shell, wholly dependent on the trustees of the subsidiary. In view of these facts it is not surprising that the Supreme Court of New York invalidated the trust. (*Gertenbach* v. *Rodnon*, 12 NYS 518, 1939.)

and this is only possible if they have access to the list of certificate holders. Stockholders have this right, though they are sometimes prevented from exercising it, but the position of the certificate holder is somewhat different. A member of the House subcommittee investigating real estate reorganizations stated that from experience it had been shown that the certificate holder cannot secure a list of the other holders from the corporation or from the trustees, as such demands will be refused, and that the courts cannot extend any assistance.[7] On the other hand, Cushing feels that "in time" the courts may force the trustees to give out this information, though he recognizes that it is "doubtful if trustees would invariably comply with such a request" voluntarily.[8] For our purpose, however, it is unimportant whether or not trustees are required by law to divulge the list of certificate holders, for, as a matter of fact, they will not do it. It is small consolation to say that the trustees may conceivably be forced to do what they should; that takes time and money.[9] The conclusion must be reached that the certificate holder has no "automatic" rights in this respect, and hence is at the mercy of the trustees. It appears obvious that this situation should be remedied by statute, if necessary.[10]

SALE OF CONTROL

Even though the voting trust is supposed to insure continuity of management, control may nevertheless change hands. Cushing writes that this is presumably the result "of the purchase of a sufficient quantity of voting trust certificates to entitle the new parties to recognition," [11] but this is surely

[7] Public Hearings, Part 2, p. 677. [8] *Voting Trusts*, p. 93.

[9] On this matter, see the remarks of Maurice Mound, as reproduced in Bonbright and Means, and quoted *supra*, p. 111, footnote.

[10] "Some voting trust agreements give certificate holders the same right to inspect the books of trustees as a stockholder under the law of the particular state would have." (Securities and Exchange Commission *Report*, Part III, p. 204.) It is of interest to note, however, that not one of the state statutes on voting trusts even mentions the subject.

[11] *Voting Trusts*, p. 121.

not the only possibility. It is at least possible that control may be sold directly without the transfer of a single trust certificate; all that is required is that a majority of the trustees resign and that other persons be elected to fill their places. To improve the appearance of the transaction, however, it may be desirable to purchase trust certificates at a price above the market.

Although details of transactions of this sort have not, so far as is known, been recorded in documents publicly available, it would be dangerous to assume that such situations have never occurred or that they never will occur in the future. With respect to the sale of control generally, it has been said that such transactions are "frequent in the financial district; and they are regarded as the private business only of the individuals and groups concerned. In effect, the position of 'control' is a valuable piece of property to its holder, and is so regarded; its value arises out of the ability which the holder has to dominate property which in equity belongs to others." [12]

If control can be, and probably is, bought and sold, what guarantee has the certificate holder that the trust will assure him the advantages of continuous and able management? Even if he thinks a given set of trustees are capable of managing the corporation, he may well wonder if they will long remain in power. Little more, however, can be said on the subject as it is not known how often trustees relinquish their control for personal gain; all that is certain is that the trustees under most agreements change over a period of years, but whether because of death or otherwise, it is difficult to determine.[13]

"SECRET" VOTING TRUSTS

At times the stockholders of a corporation may not even know of the existence of a voting trust. This can easily occur

[12] Berle and Means, *The Modern Corporation and Private Property*, p. 244.
[13] See *Ibid.*, pp. 243–44, for a discussion of the sale of control.

when the trust certificates are not generally held by the public and no effort is expended to secure deposits. Apparently this was the case with the trust of the Virginian Railway, which was not reported in Poor's. Information on the Acme Wire Company and the American Alliance Management Corporation trusts is almost totally lacking—the financial services make only occasional references to them. In fact, their existence would have gone unnoticed had not their trust certificates been traded in in the over-the-counter market.

The injustice of this situation to some stockholders is apparent, although its importance should not be exaggerated. A person may buy stock under the illusion that he has purchased a proportionate participating share in the management of the corporation, while, as a matter of fact, since it is futile to do so, he need not even trouble to cast his vote. Cushing believes that "the apparent theory of this criticism is that directors" chosen by the trustees "are not substantially interested in the corporation itself," [14] but why this necessarily has anything to do with "secret" voting trusts is difficult to understand. The real criticism rests on the right of the stockholder to know whether or not his voting power has more than a nominal existence. If his stock is, in effect, nonvoting, he should be notified of this fact before he invests; otherwise he may, year after year, go through the troublesome formality of voting.

DURATION AND EXTENSION

It has already been noted that some trusts have covered such long periods of time that the stockholder is more or less permanently disenfranchised. For example, the trust of the Mobile and Ohio (1876) and the twenty-eight-year-old trust of the Houston Oil Company are still active, though in neither case was an extension necessary. For well over a generation

[14] *Voting Trusts*, p. 38.

the trustees for these companies have assumed all of the functions of stockholders except the bearing of risks.

But far more common, and hence more important at the present time, than trusts of long contractual duration, are those which are extended from time to time. Ample evidence of the ease with which trustees can persuade certificate holders to assent to extensions is found in the number of examples: thus, included in this class are the trusts of Armour and Company, Balfour Building, Bankers Trust, Bunker Hill and Sullivan Mining, Cable Electric Products, Compo Shoe Machinery, Gold Dust, Gorham Manufacturing, Gulf States Steel, International Mercantile Marine, International Nickel, Kansas City Public Service, Keystone Telephone, Loose-Wiles Biscuit, Planet Steamship, Rio Grande Valley Gas, and L. C. Smith and Corona Typewriters. Some of these trusts have been extended more than once. A five-year trust for the Gorham Company was created on reorganization in 1924, but was extended in 1929 and again in 1933 so that it did not finally terminate until 1939. Columbian Carbon was reincorporated in 1920 with a trust similar to its previous one, dated 1915; the trust expired November 1, 1940, after having been extended for several successive five-year periods. The voluntary reorganization of the Rio Grande Valley Gas in 1935 (which extended the maturity of its bonds, lowered the interest, and gave stock to the bondholders), necessitated a change in one of the three trustees, but did not disturb the ten-year voting trust which had been formed on incorporation of the company in 1927; [15] in 1937 eighty percent of the common stock assented to the extension of the trust for a further period of ten years. Thus the certificate holders agreed to leave control of the corporation in the hands of substantially the same group which had control at the time of its failure,

[15] No doubt the reorganization was more easily carried out because of the voting trust.

and there was little that the nonassenting stockholders could do about it. In effect, the majority signed away not only their own voting rights for ten years but also the rights of the minority. Of course the minority could continue to vote, but to no practical effect.

A few trusts have been extended, in a sense, without any action on the part of the certificate holders. The Reading Company trust was to expire on the payment of two successive preferred dividends of four percent each, but such a payment was not made until several years after it was possible to make it. In 1902 the payment of all but one percent of the required amount occasioned considerable comment, but we are told by a contemporary writer, that the "best informed circles" in Wall Street considered the action conservaative.[16] The trust was finally ended in 1904, ten years after its creation.

Although a number of other examples of the extension of voting trusts might be cited, little purpose would be served; the present evidence is sufficient to show that trusts may be, and are, easily extended. If the voting trustees themselves own a substantial minority of the certificates, the problem of extension is further simplified. With the aid of devices to force the deposit of stock, they should have no difficulty in securing the assent of a majority of the certificate holders. But it is not necessary for the trustees to own a single share, for it appears that as a rule they can gain sufficient assents to command control by threat and persuasion.

It cannot be said that these trusts are usually extended because "the original object of a voting trust may not have been wholly accomplished during the term for which it was created." [17] In fact, it is rare indeed that any connection exists between the extension and the original purpose of the trust; on the contrary, new reasons are frequently conjured

[16] Editorial in the New York *Sun*, August 28, 1902, p. 8. See also the New York *Daily Tribune*, August 29, 1902, p. 12.

[17] Cushing, *Voting Trusts*, p. 87.

up for each new extension. A more realistic explanation is to be found in the desire of the control to fortify its position and avoid future difficulties with the stockholders.

TERMINATION BY TRUSTEES

It should here be pointed out that trustees have terminated a number of trusts prior to the date of expiration, though proportionately the number so terminated has been small. Included in this group are the following trusts: Baltimore and Ohio (terminated two and one-half years early); Bunker Hill and Sullivan Mining Concentrating (one year); American Commercial Alcohol (one year); Aeronautical Industries (four years); Brockton Gas Light (three months); and the Virginian Railway (nine years).[18]

There appears to be no reason for the termination of most of these trusts, except, presumably, the desire of the trustees to be relieved of unnecessary responsibility. Every trust held at least a majority of the stock, and several held all of it; thus it must be said that the trustees not only voted to curtail their own power, but also that this power was genuine and substantial. The unusualness of this event is further evidenced by the favorable comment resulting from the termination of the Northern Pacific trust in 1901.[19]

CONTROL AFTER TERMINATION

Even after the termination of a voting trust the voting rights may not immediately be restored to the stockholders. The inertia of the certificate holders may lead them to permit the trustees to hold their stock for several years; Cushing cites several examples to show that large amounts of stock have been so held for periods up to ten years.[20] Two years after the expiration of the Interborough Rapid Transit trust

[18] The Virginian Railway voting trust was terminated because the trustees disposed of the stock.

[19] *Commercial and Financial Chronicle*, LXXI, 989.

[20] *Voting Trusts*, pp. 85–86.

in 1937, about ten and one-half percent of the total outstanding stock was still in the hands of the trustees; and voting trust certificates of the Balaban and Katz Corporation were bought and sold in 1939, six years after the expiration of the trust.

This situation may prove most unfortunate for any group attempting to gain control over a corporation, as the existing control has the advantage of the support of a good share of the stock which would probably not otherwise be voted. In the same way the individual stockholder who exchanged his certificates may have done so to no avail; he may vote, but so long as the trustees command a majority of the stock his power has not been increased by the expiration of the trust. Obviously, most trustees will not object to this added "responsibility," and it is to be wondered whether or not the one remaining trustee of the Interborough Rapid Transit had the interests of the certificate holders at heart when he extended the time limit for the exchange of certificates for stock. In any event, provisions in the trust agreement permitting trustees to vote unreturned stock for an indefinite time are difficult to defend from the viewpoint of sound public policy, and, for this reason, they should be eliminated. The stock should be returned forthwith to the certificate holders if they do not demand it of their own accord.

MARKET PRICE OF STOCK AND CERTIFICATES

Any statistical study designed to compare the market price of trust certificates with that of the stock of the same company is sure to encounter difficulties. Only a minority of the companies with voting trusts have stock held by the public, and of these there is seldom an active market for both certificates and stock; comparisons must, therefore, be questionable and generalizations hazardous. Nevertheless, it is said "that when both stock and voting trust certificates representing the same issue of stock are on the market, the market price

of the latter may be, by a fraction of a point, lower than that of the former. The difference is slight and not much attention has been given to the matter." [21] On the other hand, Dewing, writing in 1921, states that both the stock and certificates usually sell at the same price.[22] But whatever the outcome of this argument,[23] stockholders and certificate holders benefit, or suffer, alike, so there is ordinarily no reason why one form of security should sell at a higher price than the other. An exception to this rule might develop when the trustees do not hold a majority of the stock, but this is a rare event.

COMPENSATION OF TRUSTEES

Trustees may be compensated in two ways: by business patronage and by salary. The former arises from their right to direct the purchases, insurance, and management of the corporation, as well as to choose agents and attorneys for the trust. The trustees may direct these expenditures toward themselves or toward their friends. In short, control has value, and the trustees may appropriate this value if they choose.

[21] *Ibid.*, p. 92.

[22] *Financial Policy of Corporations* (1st ed.), III, 149.

Inasmuch as the conclusions of both Dewing and Cushing are not supported by argument, their processes of reasoning are not here susceptible of examination. It may be noted in passing, however, that differential elements of superiority may conceivably be attached to either stock or voting trust certificates, with consequent reflection in the price. The voting power which normally attaches to stock but not to certificates might, on occasion, possess monetary value. And, similarly, if the certificates are listed, but the stock is not (under circumstances such as have already been described above), this too may affect market quotations. If both situations exist simultaneously, the result, as indicated by the price differential, would represent a compromise between opposing forces (of which there may be others) and the outcome would depend on which was stronger.

[23] The trust certificate of the Transcontinental Air Transport, Inc., were quoted during 1929 at about one point below the price for the corresponding stock; while there was only one-quarter to one-half a point difference (but in the same direction) in the quotations of the certificates and stock of the United States Radiator Corporation. The voting trust certificates of the American Water Works and Electric Company during 1932 sold a point and one-half to two points below the related stock though the majority of the stock was in the trust and both the stock and the certificates were listed on the New York Stock Exchange.

Business patronage is important whether, from the point of view of the security holder, the money is spent wisely or not; it "constitutes one of the chief emoluments of control." [24]

An example of how these profits come about is the case of the Realty Bond Company. This company, "allied to the Straus interests" in California, was given management contracts for five properties controlled by trustees appointed by a Straus reorganization committee.[25] Hence, the trustees represented the same interests which received the contracts. On the other hand, they might have dealt directly with themselves, had they chosen to do so, as this procedure is permitted by most trust agreements.

In contrast to this example, the American Bond and Mortgage reorganization committee, headed by Dayton Keith, set up the Central Management Bureau for the purpose of managing and supervising some twenty properties. The profits from this concern have been turned back to the properties, although there was no legal obligation for so doing. Numerous voting trusts have been created by this committee, but according to Mr. Keith there has, up to "the present time," been no trustee "who gets any emoluments or any fee for acting as voting trustee." [26] Instead, Mr. Keith is paid a total of $15,000 a year for his work with the Central Management Bureau and as chairman of the committee; but the future may tell a different story, for all of the trust agreements provide that the trustees "shall be entitled to a reasonable compensation for their services." [27]

Several of the stockholders and two of the trustees of the Six-Twenty Jones Corporation, incorporated in 1932 to acquire at a foreclosure sale the property of a hotel company located in San Francisco, asked the court to remove three of the trustees because of their misuse of the corporate funds. W. K. Bowes, E. L. Bowes, and Arthur H. Garland, the de-

[24] Securities and Exchange Commission, *Report*, Part III, pp. 211–12.
[25] *Ibid.*, Part I, p. 154; Part III, p. 212.
[26] *Ibid.*, Part III, p. 207.
[27] *Ibid.*

fendants, who controlled the corporation to the exclusion of the two other trustees (even though all five were directors), selected Bowes Brothers and Company, owned by the first two men, to manage the property at a fee of $100 a month. Among the events leading to the suit, W. K. Bowes took $600 from the corporate funds without the consent of the directors (giving half of it to his brother) on the pretext that he believed their salary was to be increased; but when the directors did not immediately meet to vote such an increase the money was returned. Several months later, however, in October, 1934, the three defendants as directors voted an increase in the compensation of Bowes Brothers retroactively as of January 1, 1934. In view of these transactions the court decided that the Bowes Brothers (but not Arthur H. Garland) should be removed from office and debarred from appointing their successors.[28]

Banking trustees are commonly remunerated by underwriting and other fees. Kuhn, Loeb and Co., along with other banking houses, controlled the 1917 reorganization of the Missouri Pacific Railroad, which preceded the formation of a five-year voting trust. "The voting trustees, by the terms of the [reorganization] plan, were to be persons approved by the reorganization manager (Kuhn, Loeb & Co.) by the 5 percent bondholders' committee (on which Kuhn, Loeb & Co. was represented), and by the 4 percent bondholders' committee (on which Kuhn, Loeb & Co. was also represented)." [29] As a result of this procedure the Missouri Pacific was under the control of persons friendly to Kuhn, Loeb until 1930.[30] To this banking house, between the beginning of the

[28] Six-Twenty Jones Corp. *Moore* v. *Bowes*, 64 P 423 (1937).

[29] U.S. Senate, Committee on Interstate Commerce, Investigation of Railroads, Holding Companies, and Affiliated Companies. Additional Report No. 25, Part 7, p. 5.

[30] In view of the fact that Section 10 of the Clayton Antitrust Act provides that if a banker is a member of the board of directors of a railroad his firm may not underwrite the securities of that company in amounts exceeding $50,000 in any one year except after competitive bidding, none of the directors were partners of Kuhn, Loeb. Instead, directors friendly to the bankers were

receivership, in 1915, and 1930, the railroad paid out, (1) $1,244,000 for its services and expenses as reorganization manager, (2) $240,000 as compensation for underwriting the securities resulting from the reorganization, and (3) $3,408,000 for underwriting later security issues.[31] The items total $4,892,000. In addition to this, however, Kuhn, Loeb, as reorganization managers and later in association with the trustees, had the power to appoint law firms, trust companies, transfer agents, registrars, etc., to a number of remunerative posts.[32]

Aside from the right of the trustees to direct the business of the trust and the corporation toward themselves and their friends, they may make themselves officers, and thus receive a salary in this capacity. This form of compensation may be exceedingly important in the real estate field because the same man may be an officer of a number of corporations. For example, in 1939 Mr. Keith was president of six [33] corporations, but it does not appear whether he was paid in this capacity

chosen. For example, Mr. Matthew C. Brush, who was appointed a member of the Missouri Pacific's board of directors apparently at the suggestion of Mr. Otto H. Kahn, of Kuhn, Loeb, wrote in a letter to a member of the law firm representing both the Missouri Pacific and Kuhn, Loeb and Company, "I am thoroughly conscious of the fact that it was through Mr. Kahn's courtesy that I am serving on the Missouri Pacific Board and my only interest naturally, therefore, is to so discharge my obligation there as to be a credit to him" (letter dated Feb. 13, 1923). And in another letter to the same man he writes: "In the absence of Mr. Kahn, will you please use me in any way best for his interest in connection with the Missouri Pacific situation?" (The letters are exhibits Number 1626 and 1627, printed in the Senate hearings on which the above report is based. Part 13, 1939).

[31] U.S. Senate Committee, Investigation of Railroads. . . . Additional Report, No. 25, Part 7, p 3. See in addition Subcommittee on Interstate Commerce, Hearings pursuant to S. Res. 71, Part 13, pp. 5816–19.

[32] The success of the Kuhn, Loeb appointed management was not impressive. During the nineteen-twenties the railroad embarked upon an ill-considered expansion program in which the stock of other railroads was acquired by funds obtained largely by increasing the bonded debt of the Missouri Pacific. Eventually, bankruptcy ensued (in 1933). (For additional details see the Hearings pursuant to S. Res. 71, Part 13, especially pp. 5631–5724, 5842–5849; and see also the Additional Report, No. 25, Part 7, pp. 19–24.)

[33] This figure was compiled from Moody's 1939 real estate manual.

or not. However, the important thing is that the trustees can make themselves officers of every corporation they control, and pay themselves a full time salary for every such position they hold.

In a previous chapter we learned that the voting trust agreement usually provides for the compensation of the trustees, but only occasionally is the salary specified. Far more often the trustees decide what they shall be paid after the creation of the trust, and since the amount is seldom, if ever, revealed by them, the most fruitful sources of information are the investigations conducted by some government agency.

From such a source, for example, it may be learned that the "voting trustees for many of the properties reorganized by committees for real estate bonds originally distributed by S. W. Straus and Company of Illinois are compensated on the basis of one percent of the gross revenue, divided between the three trustees for each property. For 31 properties (which constituted only a sampling of cases in which voting trusteeships were present upon reorganization of Straus issues in Illinois) the voting trustee's fees on the basis of such charge amounted to between $35,000 and $40,000 a year. . . . In the case of Straus issues reorganized in Southern California the ordinary maximum to each of the three trustees was $250 a month for larger issues. Further fees are paid to these trustees for any extraordinary services demanded in the course of their duties." [34]

From the public hearing before a House committee investigating real estate reorganizations we learn that each of the trustees of the Washington Properties, Incorporated, a twenty million dollar company, receive $3,600 a year.[35] Surprisingly, the trustees of 625 Skinker Apartment receive $3,000 a year apiece, although the total value of the property is only about half a million dollars. When the trustees get $9,000, in addi-

[34] Securities and Exchange Commission, *Report*, Part I, p. 152.
[35] *Ibid.*, Part III, p. 214.

tion to the other costs of managing the property, it is to be wondered how the certificate holders can expect to receive anything.[36]

Unless it can be shown that the compensation of the trustees is a deduction from the normal costs of managing a corporation, the corporation must through their efforts earn, in addition to what it would earn without a trust, an amount at least equal to this pay in order to justify the extra expense. In the case of the Skinker trust, this was probably impossible; but even large salaries for, say, railroad trustees might be financially justified. If the trustees cannot earn their own salaries, the amount must be directly or indirectly deducted from funds otherwise belonging to the security holders.

Although there is no doubt that salaries of trustees constitute an additional financial burden upon corporations with voting trusts as compared with other corporations, it is not so clear that other forms of trustee compensation represent an addition to corporate expense. However, even with respect to business patronage, the position of trustees is exceptionally strong, for, among other things, they are commonly permitted to contract with the company as a result of the inclusion of specific immunity clauses in trust agreements. As trustees, they can require the corporate officials to purchase from themselves, as individuals, insurance, coal, or anything else, with impunity, so long as they do not commit fraud. Of course the security holders and the corporation are not directly harmed by these transactions so long as the prices paid for the services and goods are reasonable, but fraud under these circumstances would be difficult to detect. "It is not enough," says the Securities and Exchange Commission in this connection, "that the contracts be fair. The vice of the transaction is that the trustees frequently will be on both sides of the bargain. The solution lies in the abolition of such immunity clauses" in trust agreements.[37]

[36] *Ibid.*, Part III, pp. 205–6.

[37] *Ibid.*, Part III, p. 214.

JUDICIAL CONTROL OVER THE VOTING TRUST

Only in exceptional cases can the security holders expect protection from the courts after the completion of a reorganization. Nevertheless, it sometimes happens, as in the case of the Mortgage Service Company of Philadelphia, that the court retains jurisdiction over the trustees for the duration of the trust. More commonly, "the last contact of the court with the situation will be its review of the plan under which the voting trust . . . is set up. To be sure, the courts or commissions in these situations sometimes make changes in the trusts or in the trustees proposed, but such scrutiny is more likely to be exercised by Federal courts acting under Section 77B of the Bankruptcy Act than by the state courts."[38] Quite possibly the voting trust would be more seldom abused if such continuing supervision were more common.

EARNINGS OF FIRMS WITH AND FIRMS WITHOUT VOTING TRUSTS

An effort was made to reach some conclusion regarding the financial success of corporations with voting trusts. The earnings of sixty-seven real estate corporations reorganized during the thirties with trusts were compared with the earnings of similar corporations without trusts. Although, on the average, the corporations without trusts earned substantially more in proportion to their capital, the difference in mean between the two groups was not found to be statistically significant. In view of this, it was thought wise to leave the data for examination in Appendix IV.

CONCLUSIONS

In examining the position of the certificate holder and stockholder under the voting trust, we find that stockholders are often forced to deposit their stock with trustees; that they are denied the right of protecting themselves by communi-

[38] *Ibid.*, Part III, pp. 205–6.

cating with their fellow certificate holders; that control may be sold, to their detriment; that a stockholder may be ignorant of the existence of a trust; that trust agreements are commonly extended, and little can be done to prevent it; that control does not necessarily return to the stockholders on the termination of the trust, but may remain with the trustees; and that the courts seldom retain control over the trustees after a corporate reorganization.[30]

[30] Although there is no positive way of determining the connection, if any, between the expiration of a particular trust and the initiation of dividend payments on the stock formerly held in trust, the three following examples are of interest.

No dividends were declared on the stock of the Loose-Wiles Biscuit Company from the formation of a trust in 1912 until its termination in 1927 although the earnings of the company were ample for the purpose. (From 1922 to 1926, inclusive, per-share earnings amounted to $37.97.) Less than three months after the termination of the trust (on August 1, 1927) an initial quarterly dividend of 40¢ per share was paid. As a consequence of the change in policy $.80 per share was paid in 1927, $1.60 in 1928, and $2.35 in 1929.

Wilson and Co., Inc., paid no dividends from 1915, the year in which a trust was created, until May 1, 1919, fourteen months before the expiration of its trust, although earnings amounting to over $16,000,000 were available for such a purpose. In spite of its former policy, however, the company continued to pay substantial dividends during the year 1920 in the face of a growing deficit.

The third episode concerns the Worthington Pump and Machinery Corporation. Less than a year before the termination of its voting trust, in April, 1921, the initial dividend was paid on the stock. Whereas earnings had been large for the three years preceding 1920 and no dividends were declared, dividends of 5% were paid in 1921 and 2% in 1922, although no earnings were available for the purpose in either year.

An effort to compare the dividend disbursements of corporations with trusts to those without trusts proved fruitless because of the difficulties of securing comparable companies.

— VII —

THE LAW OF VOTING TRUSTS

IN SPITE OF THE FACT that voting trusts have been used for about three-quarters of a century, controversy over their legality is almost as animated now as in the past. One recent writer tells us that "Courts cannot forbid voting trusts, and have not attempted to do so, but have merely declared that the particular trust offended some legislative forbiddance or inhibition"; [1] while a second says that "The courts have not taken a definite stand on the matter one way or the other in more than six or seven jurisdictions. What little law there is is definitely in the direction of illegality." [2] Even though the existence of this controversy has been recognized by many writers [3] its importance should not be overestimated. The apparent conflict of opinion is largely the result of verbal differences in the form which the analysis of the subject takes in the hands of various writers, rather than of any fundamental disagreement in principle. This fact will become more evident as we proceed.[4]

[1] Fletcher, *Cyclopedia of the Law of Private Corporations*, V, 290.

[2] Bergerman, *Yale Law Journal*, XXXVII (1927–28), 469.

[3] Miller, *Indiana Law Journal*, IV (1928–29), 600.

[4] It is not proposed in this chapter to follow the usual procedure of citing a large number of cases to see what principles, if any, emerge from them, but instead, we shall confine ourselves to a compact statement of the general rules, and comment upon the discussions of other writers. The reader who is interested in the detailed cases, which is after all an integral part of the subject, may be referred to the extended examination of the law of voting trusts found in Fletcher's *Cyclopedia of the Law of Private Corporations*, Vol. V. This work may be recommended, not only because of its monumental character, but also because it is kept up to date by an annual supplement.

EARLY OPPOSITION TO VOTING TRUSTS

Regardless of the present difference of opinion among authorities as to the legality of voting trusts, they nevertheless are generally agreed that the courts in early cases treated them harshly. In 1902, it was said that the "courts do not regard voting trusts with favor. In all except a few cases they have been held invalid." [5] The inclination of the courts in these early cases was to condemn all voting trusts, but where justice was better served by upholding them, the courts usually did so.

Probably the most frequently cited case involving the legality of a voting trust is the Shepaug case.[6] This appears to be the first case (1890) in which a court attempted a comprehensive analysis of the principles involved.[7] In spite of the fact that the case involved fraud it is usually cited to show that voting trusts are invalid *per se*. The court held that the stockholder has a duty to his fellow stockholders and cannot strip himself of the power to perform it. Later decisions tended to be more lenient so that one writer felt justified in saying that "by the year 1905 or thereabouts, the decided weight of legal authority had come to recognize that there was nothing illegal or contrary to public policy in separating the voting power of the stock from its beneficial ownership." [8]

It is not to be imagined, however, that voting trusts had no supporters. An article in the *Harvard Law Review* of 1897 is devoted to their defense and proceeds to point out the fallacies in the logic of the courts which held them invalid. In short, the author argues that voting trusts for any legitimate purpose should be permitted.[9] In this connection it is of interest that in the first case involving a voting trust (1867) the court

[5] Moore, *American Law Review*, XXXVI (1902), 222.

[6] *Bostwick* v. *Chapman*. *Star-Buck* v. *Mercantile Trust*, 60 Conn. 553 (1890); 24 Atl. 32 (1890).

[7] Smith, *Columbia Law Review*, XXII (1922), 628.

[8] Wormster, *Columbia Law Review*, XVIII (1918), 124.

[9] Jesse W. Lilienthal, *Harvard Law Review*, X (1896–97), 428–38.

held the trust to be a valid one, and refused to break it for the benefit of a rival company.[10]

WHEN IS A VOTING TRUST VALID?

Rather than attempt to formulate a general rule for determining the validity of voting trusts, it will be preferable to take up three different approaches which have been made to the problem of establishing such a standard. First is what may be termed the "invalid except" rule, as developed by Marion Smith.[11]

Mr. Smith begins with the assumption that the prevailing American doctrine is that a voting trust, whereby the beneficial ownership of stock is separated from the voting power, is contrary to public policy and illegal. Immediately, however, he qualifies this statement by enumerating three classes of exceptions to the general rule which the courts sanction. First, a trust created for the purpose of securing a debt, and ending when the debt is paid, is valid. Such a trust may be justified by the fact that the corporation might otherwise find it difficult to borrow. Second, a trust is legal when it is created for the purpose of carrying out a fixed policy for the corporation and is binding on the trustees. A trust formed for the purpose of liquidating a corporation, for example, would come under this classification. Here the stockholders have decided on a course of action and a trust is the most convenient way to carry it out. Thus it is inferred that the stockholders have not been relieved of control in any real sense. Third, a trust will be sustained by the courts when it is the result of a reorganization and its purpose is to protect those financing the reorganization.

A second approach to the validity of voting trusts is found in the works of William Fletcher and Maurice Finkelstein.

[10] *Brown* v. *Pacific Mail S.S. Co.*, 5 Blatchford 524 (1867). A number of different writers discuss this case and all agree there is no earlier litigation involving voting trusts, so far as they know.

[11] *Columbia Law Review*, XXII (1922), 627–37.

The former tells us that "the general rule is that the purpose of the voting trust agreement determines its validity, and that if that is lawful it is valid, provided it can be accomplished in a lawful way." [12] Similarly, Finkelstein [13] writes that the court, in nearly every case in which a trust was held to be against public policy, "was opposed, not to voting trust agreements *per se*, but to the objects of the contracting parties." Thus these two men, as well as many others, including Cushing, agree that the important point in determining the validity of a trust is its object or purpose. Provided, then, that the trustees can justify the creation of the trust to the satisfaction of the court and that no fraud has been perpetrated on the stockholders, the court will hold the trust valid. Fletcher adds another qualification by pointing out that it must be "accomplished in a lawful way." The full meaning of this is recognized when it is remembered that a court might hold a trust invalid if the state statute prohibits proxies for more than a given period. This seems to point to the conclusion that a court which is deeply convinced as to the illegality of a trust will be able to find a legally satisfactory reason for an adverse decision.

Another approach to the determination of the validity of voting trusts is developed by Milton Bergerman.[14] Here the validity of trusts is made to turn on the question of minority control. Voting trusts are divided into four classes: (a), those that do not involve minority control; (b), those that involve minority control incidentally in accomplishing a socially desirable end; (c), those which are used to effect an illegal purpose; and (d), those which squarely present the problem of minority control. Included under class (a)—trusts which do not separate control from beneficial interest—are trusts resulting from reorganizations where creditors will provide more money only if given control and those cases where bank-

[12] *Cyclopedia of the Law of Private Corporations*, V, 301.
[13] *Michigan Law Review*, XXIV (1925–26), 346.
[14] *Yale Law Journal*, XXXVII (1927–28), 445–67.

ers will lend to a successful corporation only when given a measure of control. Also included in this class are trusts created for a definite purpose, say, to liquidate a company. In the case of the Interborough Rapid Transit Company the trustees were to represent the various classes of security holders, and thus the trust would fall into this class. Since minority control is not involved in these cases, the writer concludes that they are legal. As a matter of fact it must be assumed that the trustees actually represent the majority in interest of the security holders whom they purport to represent; otherwise it cannot be argued that there is no minority control.

As an example of a trust which involved minority control incidentally in accomplishing a socially desirable end, Bergerman cites the case of the corporation manufacturing submarines where a trust was created for the purpose of preventing control of the company from falling into enemy hands. The court upheld this trust in spite of the fact that there was minority control. Under class (c) are those trusts which involve both minority control and illegal purpose. The Shepaug case is cited in which a railroad company was milked by means of a construction company. This class of trust is clearly invalid. Class (d) presents the problem of minority control in a pure form. Here the writer cites cases to show that the courts have sometimes held such trusts to be valid and sometimes to be invalid. However, his general conclusion appears to be that at best such trusts are of doubtful validity.

The preceding lawyers have set up three different standards for determining the validity of voting trusts. The first writer told us that all trusts, except certain types, were invalid. The second group of writers made the object or purpose of the contracting parties determine the validity of a trust. And lastly, we were told that the question of minority control is the deciding factor. Before drawing any conclusions from these conflicting views, however, we will attempt to classify some of the reasons, both specific and general, which courts have given for holding particular voting trusts invalid.

REASONS FOR INVALIDITY

The following list of such reasons does not pretend to be exhaustive. It should be borne in mind that courts obviously differ in their views, and it cannot be assumed that a particular trust is illegal because it might be found offensive in some jurisdictions.

"Public policy" [15] is the factor most often cited by the courts when invalidating a trust. Sometimes, especially in the earlier cases, the courts gave no other reason for their decision so that it has been assumed that the courts believed all trusts to be against public policy. As a rule, however, the courts have mentioned some specific reason, such as those described in the succeeding paragraphs. In a sense, most of these reasons are subordinate to the general question of public policy, but for the sake of clarity it is best to list them separately.

The specific grounds for the invalidation of voting trusts agreements most often given by the courts is the separation of ownership and control. It has been argued by some courts that the right to vote is an incident of the ownership of the stock and cannot exist apart from it. Most professional writers on the subject give a demonstration of the so-called "legal mind" by pointing out that ownership of stock and voting power are not separated by a voting trust, as legal title to the stock rests with the trustees and not with the beneficial owners of the stock. Such an argument may satisfy those who use it, but would convince few others that it was anything but legal hairsplitting.

Another ground for invalidation is that of "revocable

[15] "Public policy" is an indefinite concept which can best be defined in negative terms. Thus one court holds that those contracts are against public policy, and hence void, "which tend clearly to injure the public health, the public morals, or confidence in the purity of the administration of the law, or to undermine that sense of security for individual rights, whether of personal liberty or private property which every citizen has a right to feel" (*Holland* v. *Sheehan*, 108 Minn. 362, 1909).

proxy." The courts have often reasoned that a voting trust is nothing more than a proxy, and, since there is no such thing as an irrevocable proxy, voting trusts are revocable by any of the contracting parties. This reasoning requires the courts, if they adhere to logic, to deny that title to the stock rests with the trustees. California courts held to this idea until a state statute was passed.

Some courts have objected to voting trusts on the ground of "indefinite or perpetual duration." Thus, a voting trust which may never terminate, or one which is by its terms perpetual, or runs, say, for one hundred years, may have a difficult time in some courts.

A "dry" or passive trust is one in which the trustee is merely a passive title holder to property, with no duties to perform. When voting trusts have been held to be of this type, the courts have sometimes said that the trust was revocable in the sense that the certificate holders may demand the return of their stock at any time.

One voting trust agreement, which provided for the payment of a certain salary to an employee as part of the consideration for the formation of the trust, was held to be invalid on the ground of "illegal consideration"—the court did not consider the object of the contract a proper one.

The charge of "restraint of trade" arises when the effect of a trust is to place the control of one corporation in the hands of a second corporation, or when several corporations are controlled through one voting trust. The Standard Oil trust and some of the railroad trusts were of this type.

The courts have sometimes held that the mutual promises of the depositors and the trustees did not constitute "sufficient consideration." This possibility has led to the inclusion in the voting trust agreement of a recital designed to show sufficient consideration.

Some of the older voting trust agreements made no provision for nonassenting stockholders to deposit their stock

after the beginning of the trust, and a few excluded certain stockholders. The courts have inferred from this that if not all the stockholders are permitted to join, the trust must be for the benefit of the depositing stockholders, and thus, by "exclusion," not in the interests of all. However, Fletcher says that such an agreement might be valid provided "that by the exclusion there was no unfairness, fraud or illegal control." [16]

Other voting trusts have consistently been held invalid if they were created for an "illegal purpose." The illegal purpose may be attempted monopoly as mentioned above, or an effort on the part of the trustees to defraud certain stockholders. It is a general rule that stockholders may not combine in order to make unfair profits at the expense of the other stockholders.[17]

Apparently it makes little difference whether one says that all voting trusts are valid except specified classes, or that with certain exceptions, no trusts are valid. The conflict between these two schools of thought seems to be one of phraseology and not of principle. Similarly, the practical result of the effort to classify trusts according to the element of minority control involved in the trust is no different. Here the same trusts are declared invalid even though the process of reasoning differs slightly. The important question which remains to be answered is whether any general rule or classification can be set up which will aid in determining the probable validity of a particular trust. One thing is apparent from reading the list of the reasons given by the courts for holding certain trusts invalid: any effort to enumerate the types of trusts which are legal must ignore both those courts which have held voting trusts invalid *per se* and those decisions which have made it impossible to create a legal trust. On the other hand, any attempt to list or to classify the illegal purposes or uses of voting trusts is futile. The exceptions to any rule which may be created are so numerous that the rule

[16] Fletcher, *Cyclopedia*, V, 317. [17] *Ibid.*, V, 297, 306.

ceases to be a guide. The decisions of the various courts just do not fit into any convenient arrangement. Broadly speaking, however, it is sufficient to remember that the courts, under common law, are more likely than not to uphold any reasonable voting trust agreement. But, in some jurisdictions, particularly North Carolina, all trusts may be declared invalid.

LEGAL POSITION OF THE CERTIFICATE HOLDER

All authorities agree that as a general rule the certificate holder has all the rights and liabilities, except voting, of a stockholder. The courts have often taken the attitude that the certificate holder has only transferred his voting power to the trustee. Thus these courts have ignored the provisions in the trust agreement transferring the legal title of the stock to the trustee. For example, a certificate holder may sue the directors and officers of a corporation to recover damages. But, as a stockholder is also required to do under similar circumstances, the certificate holder must sue in his own name for the benefit of the corporation.[18]

For all practical purposes voting trust certificates have been held to be negotiable to the same extent and in the same manner as stock certificates. However, with respect to taxation, voting trust certificates may or may not be treated as stock certificates depending upon the jurisdiction. There appears to be no general rule in this respect.

STATE STATUTES

The first state to pass a statute permitting voting trusts was New York, in 1901. By this law, trusts could be created for a period of up to five years.[19] By the year 1928 eight states had legislated on the subject,[20] and by 1939 nineteen

[18] Cushing, *Voting Trusts*, pp. 177–79; Fletcher, *Cyclopedia*, V, 327, III (Supplement, 1939), 168; *University of Pennsylvania Law Review*, LXXXI (1935–36), 339–40.

[19] Cushing, *Voting Trusts*, p. 140.

[20] Bergerman, *Yale Law Journal*, XXXVII (1927–28), 464.

STATE STATUTES

State	*Trusts permitted for 10 years*	*Trusts not to exceed 10 years*	*Trusts not to exceed 15 years*	*Trusts not to exceed 21 years*	*All Stockholders must be permitted to join*	*Voting trust agreement must be open to inspection*	*Trustees may vote by proxy*	*Trustees liable only for malfeasance*	*Trustees liable for malfeasance and neglect*
Arkansas		X			X	X			
California				X [b]		X			
Colorado	X [a]				X	X	X		
Delaware		X				X	X	X	
Florida		X			X	X			
Idaho		X			X	X	X		X
Louisiana		X			X	X	X		X
Maryland		X			X	X			
Michigan		X				X	X		

Minnesota			X [c]			X	X		X
Nevada			X		X	X			
New Hampshire [d]		X				X			
New Jersey		X				X		X	
New York [e]		X			X	X			
Ohio	X [a]					X			
Pennsylvania		X					X		X
Tennessee		X				X			
Washington		X			X	X	X		X
West Virginia [f]		X					X	X	
Totals	2	14	2	1	9	17	9	3	5

[a] Duration of trusts permitted by common law not limited by this statute. Common law right in addition to statutory right.
[b] Irrevocable trusts may not exceed 21 years, but if revocable by certificate holders, they may be of any length.
[c] When created in connection with a debt a trust may last until the debt is paid regardless of the number of years.
[d] Banks not permitted to have voting trusts, and real estate trusts limited to five years under certain circumstances.
[e] Banks, insurance, and loan companies not permitted to have voting trusts.
[f] All stockholders may join but only within the time stated in the agreement or set by the trustee. In any event, however, the stockholders are given months to do so.

states had laws permitting voting trusts. No doubt the depression of the thirties was responsible for many of the statutes passed between 1928 and 1939 because of the numerous corporate reorganizations which occurred during this period. The passage of these laws also indicates the confusion existing with respect to the common law, and the desire of lawyers to avoid having their work undone through the intervention of hostile courts, which might invalidate the trusts they desired to set up.

The accompanying chart summarizes the important provisions embodied in the state laws permitting voting trusts. The only important limitation placed on trusts by these laws is to regulate their duration, and this is of importance in only some of the statutes. Out of the nineteen states having statutes, fourteen authorize trusts not to *exceed* ten years, while two *permit* them for ten years. These latter states explicitly provide that their statutes are not to limit the duration of any trust which would otherwise be valid under common law. In other words, the statutory right is granted as an addition to the common law right and not as a limitation. Two states permit trusts not to exceed fifteen years, but in the case of Minnesota the limitation is weakened by the provision that the statute does not apply to trusts created for the purpose of securing a debt. California law provides that an irrevocable trust may not be created for a period exceeding twenty-one years, but this statute appears to permit trusts for a period of more than twenty-one years if they are revocable after the expiration of this period.

Nine of the laws provide that all stockholders must be permitted to deposit their stock with the trustees, but not all of them make it clear whether or not this applies to both common and preferred stock.[21] Although such a provision

[21] Arkansas, Colorado, and Tennessee statutes provide that "every other holder of stock of the class or classes so transferred, or for the transfer of which such agreement in writing provided, may transfer his stock to the same trustee or trustees and thereupon shall become a party to such agree-

might conceivably be of some importance in an individual case, it is difficult to understand how it could be of much practical assistance to minority stockholders in general.[22]

All but two of the state laws provide that the trust agreement shall be open to inspection by certificate holders. The usual provision requires that the agreement be placed on file in the company's main office so that it may be inspected during office hours. Though the practical effect of this requirement is probably not great, it is nevertheless desirable.

Nine of the statutes explicity permit the trustees to vote by proxy. The necessity for such a provision appears to be in doubt. A lawyer writing in 1932 says that he has found no case adjudicating the validity of a proxy given by a trustee except in Delaware, where the statute covers the point.[23]

Eight states have limited the liability of trustees by legislation, while three of these states have gone so far as to make trustees liable only for their own individual malfeasance. The latter provision ostensibly relieves a trustee of any liability for gross negligence. The other five states are more strict, in that neglect on the part of a trustee will subject him to liability. The existence of this provision in almost half the state laws may indicate that lawyers do not entertain great expectations that courts will uphold provisions limiting the liability of trustees.

The only conclusion that can be reached by reading the various laws relating to voting trusts is that the legislators have been far more interested in facilitating the use of trusts than in regulating them. The more recent statutes have tended to be more lenient than the earlier ones so that fewer and fewer restrictions have been placed on the use of voting trusts. For example, the New York law was changed in 1923 to per-

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ment" (quoted from the Arkansas statute). The other state statutes provide that all "stockholders" or "shareholders" may deposit their stock with the same trustees.

22 On this point, see *supra*, pp. 115–19.

23 "Voting Trusts," *Harvard Law Review*, XLVI (1932–33), 333–34.

mit trusts of ten years' duration instead of five. California courts formerly restricted the duration of trusts to seven years because of a statute prohibiting proxies for a longer period, but in 1931 legislation was passed permitting trusts for a period of twenty-one years.[24] Ohio in 1932 passed a trust law which is probably more lenient than that of any other state, even including California. This law provides that trusts may be created for an initial period of ten years and may be extended for like additional periods by the assent of a majority of the certificate holders. It is not clear from the statute whether stockholders may withdraw at the termination of the first period, if a majority votes for a continuance of the trust. If stockholders cannot withdraw under these conditions it may be difficult ever to terminate a trust. This is an important point because it is much simpler to secure the assent of a majority of the stockholders to an extension of the trust when all the stock is then on deposit, than when only part of the stock is in the trust. Thus if stockholders may not withdraw, each time the question of renewal arises all of the stock is in the trust, so that the problem of getting a majority to assent to the extension is greatly simplified. The Ohio statute goes even further than this, however. It provides that the ten-year limit may be ignored if the voting right is coupled with an interest in the stock. The law first generously defines such an interest specifically and then ends with a general statement permitting trusts of any duration where the voting is coupled with a "sufficient interest." No doubt a sympathetic court would always admit the existence of such an interest.[25]

At least two courts have passed on the validity of trusts for longer than the statutory period and in both cases it was held that the statutes were intended to limit the duration of

[24] *Southern California Law Review,* V (1931), 214–23. A discussion of the California law before 1931 is found in the *California Law Review,* XVI (1927–28), 537–41.

[25] For a defense of this law see Theodore Berry, in *University of Cincinnati Law Review,* VI (1932), 64–78.

trusts. A New York case resulted from a provision of a trust agreement permitting the trustees to renew the agreement for a further period of ten years. The court held that the agreement was valid only for the first ten years but invalid thereafter.[26] On the other hand, a Delaware court held that a trust for eleven years was invalid *in toto* since the statute permitted trusts for only ten years.[27] Previously, at least, this point had been somewhat in doubt, and Cushing believed that the "broader interpretation" of the statute was more "reasonable." [28] But in view of these decisions it appears that the statutes mean what they say when they stipulate that trusts shall not exceed a given period.

It is not to be assumed that the statutes necessarily protect voting trusts from attack. In fact, one writer goes so far as to say that the statutes, if interpreted by a hostile court, "may have the effect of cutting down the common law right to form a voting trust." [29] In any event, the certificate holders have the same right to sue the trustees as under a common law trust.

In New York, and probably in other states, the courts (except as noted below) have regarded the statute as providing the exclusive basis for voting trust agreements. In so doing they have ignored the common law right to create trusts and have at the same time incurred the displeasure of those persons who would extend, rather than restrict their use.[30]

Some mention should be made of the effect on national banks of state laws that restrict or prohibit voting trusts. It appears that the question has never been adjudicated in a

[26] *Kittinger* v. *Churchill Evangelistic Association,* 151 Misc. 350, 271 N.Y.S. 510 (1934). For a discussion of this case see "Voting Trusts," *Michigan Law Review,* XXXIII (1934–35), 804–5.

[27] *Perry* v. *Missouri-Kansas Pipe Line Co.,* 191 Atl. 823; Del. Ch. (1937). For a discussion, see "Validity of Voting Trusts," *Columbia Law Review,* XXXVIII (1938), 508–11.

[28] *Voting Trusts,* p. 141.

[29] Bergerman, *Yale Law Journal,* XXXVII (1927–28), 464–65.

[30] "Validity of Voting Trusts," *Minnesota Law Review,* XXII, 276–78; and Fletcher, *Cyclopedia,* V, 280.

Federal court, but according to what little evidence there is, it would seem that national banks need not be concerned with state law on the subject. If this is correct, a national bank located in New York may have a trust regardless of the fact that state law prohibits state banks from having them. In this case the question of the validity or invalidity of a trust is left to the common law.[81]

REAL ESTATE TRUSTS

But in spite of the trend toward the increasing leniency of state laws respecting voting trusts, New York, as the result of a legislative investigation,[82] has recently passed a law restricting real estate trusts. Its general effect is to require court supervision over the formation of the trust and give the bondholders an opportunity to protect themselves. Because this law has been so recently passed, because it may serve as a model for other states and is an important step in the right direction, it is here reproduced in full:

1. No trustee or member of a committee or the attorney of such trustee or committee or any employee of either shall be eligible to become a voting trustee or an officer or director of a corporation to be formed or used under a plan of reorganization to acquire title to property previously administered by such trustee or committee unless the facts with respect to their previous connection with the property are disclosed to the court and the affirmative approval of the holders of at least fifty-one per centum of the mortgaged investment is obtained or unless a plan of reorganization approved by the court in proceedings under section one hundred and twenty-two of this chapter shall so provide.

2. No agreement appointing trustees to vote the stock of any corporation formed or used under a plan of reorganization of property shall be valid for a longer term than five years and unless it has been submitted to and approved by the court and no trustee ap-

[81] Murray C. Bernays, in *Illinois Law Review*, XXII (1928), 587–612. To the writer's knowledge this is the only discussion to be found of the law involved in this question.

[82] See the Report of the Joint Legislative Committee to Investigate Bondholders' Committees, N.Y. Legislative Documents, No. 66 (1936).

pointed by such agreement shall continue to act thereunder after the expiration of its term, unless and until a new or an extension agreement has been entered into and received the affirmative approval of the holders of at least fifty-one per centum of the stock.

3. No salary or other compensation shall be paid to any voting trustee or officer or director of a corporation formed or used to acquire the title to property in or through reorganization unless the same has been approved by the court.[33]

THE SECURITIES AND SECURITIES EXCHANGE ACTS

Under the Securities Act of 1933 and the Securities and Exchange Act of 1934, voting trust certificates are treated in the same manner as other securities. An exception to this general statement is to be found, however, with respect to the definition of the term "issuer." In the case of voting trust certificates this is defined, in both acts, to mean "the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust. . . ."[34] The Securities and Exchange Commission has ruled that "the term 'issuer' means the voting trust created by the agreement under which the certificates are issued, and not, in their individual capacities, the persons acting as voting trustees thereunder."[35]

Form 16, under the Securities Exchange Act, must be filled out and filed with the commission if it is desired that the trust certificates be listed on a national stock exchange. Form F-1 is used to register securities for "sale" under the Securities Act whether the certificates are to be issued in the course of a reorganization or otherwise.[36] "A sale of voting trust certifi-

[33] Real Property Law of New York, Section 130-c (1936).

[34] Section 3 (8) of the Securities Exchange Act and Section 2 (4) of the Securities Act.

[35] Rules as to the use of Form F-1, 4 (c).

[36] Voting trust certificates need not be registered under the Securities Act, provided:

"(a) That the aggregate amount of all securities proposed to be received subject to the voting trust agreement pursuant to which the certificates are issued shall not exceed $100,000. The aggregate amount of such securities shall be their aggregate market value as established by bona fide sales of any such

cates by the issuer thereof is involved in the submission of a plan or agreement for reorganization: (a) When an opportunity to assent to or to dissent or withdraw from a plan or agreement for reorganization is given on such terms that a person so assenting or failing to dissent or withdraw within a limited time will be bound, so far as he personally is concerned, to accept the voting trust certificates, unless at the same time he retains or is given a right subsequently to withdraw which is conditioned, if at all, only upon his payment of

securities within a reasonable time prior to the first offering of the voting trust certificates; if, however, such securities are not then outstanding, or if no such sale is known to have occurred, their aggregate amount shall be the aggregate principal amount of such securities or whichever is the greater of (1) the aggregate par, or, if no-par, stated value thereof, or
(2) the aggregate book value thereof."

"(b) That, although a voting trust certificate is exempted under this rule, no person offering such certificate in exchange for any security received or to be received subject to the voting trust agreement shall be immune from the liabilities imposed upon such person if the certificate were not so exempted unless, prior to, or at the time of, the offer of the voting trust certificate, there shall be sent or given, or in the case of a general offer by newspaper advertisement, there shall be offered to the person to whom the offer is made, a statement containing—

(1) A summary of the provisions of the voting trust agreement with respect to—

(A) The duration of the trust;

(B) The distribution of dividends, interest, or rights received on account of the securities covered by the trust agreement;

(C) The compensation, if any, of the trustees;

(D) The limitations, if any, upon their liability; and

(E) The selection of additional and successor trustees.

(2) The names, addresses, and principal occupations of the persons selected as voting trustees.

(3) If, to the knowledge of the person making the offer, any of the trustees has been designated because of his connection with, or in order to represent, any group of security holders or persons interested in the issuer of the securities covered by the voting trust agreement, a brief statement with respect to each such connection or representation.

(4) If one or more of the trustees remain to be chosen, a brief summary as to the provision of any agreement known to the person making the offer with regard to the designation of such trustee." (Rule 206) General Rules and Regulations under the Securities Act.

The voting trust certificates issued in return for exempted stock are not exempt from registration under the Securities Act. For example, this would apply to the trust certificates of a mortgage loan company. (Federal Trade Commission, Release No. 86, December 13, 1933.)

not more than his proportionate part of the expenses of reorganization, and (b) If the plan or agreement referred to is submitted by, or with the authority of, the issuer of the voting trust certificates. A registration statement for the voting trust certificates shall, therefore, be effective before such sale is made." [87]

In a number of respects the two forms are similar. First, in order to register securities under either of the acts, there is a series of questions designed to bring out the significant provisions of the voting trust agreement. For example, the issuer is required to outline the provisions relating to the restrictions on the powers of the trustees, or if there are none, to make a statement to that effect. Similarly, the manner of compensation and the limitations placed on the liability of the trustees must be recorded. The effect of these questions is to bring into relief the existence or absence of important provisions in the trust agreement.

A second group of questions, though ostensibly designed to bring out the contents of the trust agreement, appears to be more of a warning to the prospective investor to avoid the purchase of trust certificates. Question 15, in the form for registration under the Securities Act, asks for a summary of the "principal provisions of the agreement, if any, for the removal of trustees, stating whether or not the holders of certificates have any powers of removal." Question 23 asks whether or not provision has been made for determining the amount of compensation to be paid to the trustees by an independent person (provided that the amount of compensation is not stated in the agreement). No doubt these questions encourage the inclusion of provisions in the trust agreement designed to protect the certificate holders, as the issuer would surely dislike answering them in the negative.

Third, a group of questions concerning the trustees is intended to bring out their relationship to the corporation.

[87] Rules as to the use of Form F-1, 2.

Questions 2 and 8, in the registration form under the Securities Act, ask for the principal occupation of each of the trustees and their relation to the corporation, if any, in the following respects: as "(1) Officer; (2) director; (3) trustee; (4) partner; (5) counsel . . . ; (6) creditor, whose claim (not represented by security) exceeds, or at any time during the period of such relationship exceeded, $50,000; (7) beneficial owner, directly or indirectly, of securities carrying more than 25 per cent of the voting power; (8) purchaser of seller of goods or services in a regular course of dealing. . . ." A second part of this question inquires about the relationship between "The Corporation" and any other corporation in which the trustees have any interest; while a third part requests the relationship between any officer or director of such other corporation to the officers, directors, creditors, etc., of "The Corporation." It is added, that "For the purpose of this item [question], any person controlling a voting trustee is to be treated as a voting trustee." [88] This group of questions is by far the most important of any in either registration form. Before the passage of the acts such information was almost impossible to obtain, while information concerning the trust agreement proper could always be secured about a stock listed on the New York Stock Exchange, from the listing statement. The Securities Exchange Act of 1934 introduced one major change with respect to voting trust certificates which are listed on national securities exchanges and which have not been subjected to the terms of the Securities Act of 1933: viz, the availability in the registration statement of extensive information about the trustees similar to that indicated above which must be revealed in compliance with the 1933 Act.[89]

A number of additional questions in the forms develop

[88] Form 16, in a similar manner, contains a group of questions designed to develop the same point. See Questions 11 to 16, inclusive.

[89] Although this voluminous information on file with the exchanges and with the Securities and Exchange Commission may not be accessible to all without inconvenience, it is hoped that the financial reporting services will further expand their coverage to include the more significant items of this information.

other points of interest to the prospective investor. These include a request for the following: a list of all persons owning more than ten per cent of the voting trust certificates; [40] the percentage of the total stock held subject to the trust; [41] and whether or not any of the trustees have been designated to represent any of the security holders other than the trust certificate holders.[42]

Now that we have sketched in a general fashion the provisions of the two forms so far as they are similar, let us summarize and complete the information required in each form individually. First, in order to register a security for sale, the following items are required:

(a) the provisions of the voting trust agreement;
(b) the relation of the trustees to the corporation, their outside interests, etc.;
(c) the miscellaneous questions, mentioned above;
(d) a copy of the voting trust agreement;
(e) a copy of the voting trust certificate;
(f) certified copies of the orders of all governmental regulatory bodies by which any securities of the trust were denied the right to be sold; and
(g) a copy of the prospectus.

Only the information required under (a) to (c) inclusive, is required in the prospectus. All other items are a part of the exhibits attached to the registration statement and need not be included in the prospectus.

Next, for the purpose of listing trust certificates on a national stock exchange the following items are required:

(a) the provisions of the voting trust agreement;
(b) the relation of the trustees to the corporation, etc.;
(c) miscellaneous questions of interest;
(d) a copy of the voting trust agreement and trust certificates;
(e) copies of any other contracts relating to the trustees, certificate holders or the corporation which are pertinent to the trust;
(f) and most important, "Submit information as to the issuer of the underlying securities as required by the Form and Instruc-

[40] Item 25, Form 16. [41] Item 6, Form 16. [42] Item 9, Form F-1.

tion Book appropriate for the permanent registration of securities of such issuer."

This last requirement deserves special attention because it is the only item on either form which gives any information of significance concerning the underlying securities and their issuer. All of the other information required relates, directly or indirectly, to the voting trust, and adds little to an understanding of the merits of the underlying securities. However, on a public offering of voting trust certificates the Securities Act requires a registration statement and a prospectus containing the information that would be required on an offering of the shares themselves.

The Securities Exchange Act of 1934 provides for the filing of annual reports by the issuers of securities both under this act and the Securities Act. Form 3-MD under the latter act, and form 16-K under the Securities Exchange Act pertain to trust certificates. The purpose of the annual reports is to keep the information contained in the registration statements up to date. These two forms are identical except in one important respect. Form 3-MD, relating to the Securities Act, makes no provision for information concerning the underlying securities. The general character of the question asked in these forms may be summarized by saying that any change in the voting trust agreement, or any change in the trustees, must be reported. If a new trustee is appointed he must answer the same questions that were asked in the original registration statement. Likewise, when a trustee enters into a contract with the corporation, not previously reported, this fact must be included in the annual report. In short, the only effect of the annual reports is to keep the information in the registration statements up to date.

Section 16 (a) of the Securities Exchange Act provides that officers, directors, and principal stockholders of a corporation having securities listed on an exchange must report monthly on any change in their holdings of equity securities.

provision, and thus must report any sale or purchase of an equity security. This information is published by the Securities and Exchange Commission twice a month. It should be noted that trustees of securities registered under the Securities Act, but not listed on an exchange do not have to file this report; but, the same information, on a yearly basis, is obtainable from the annual reports mentioned above.

When a corporation has securities listed on a national security exchange it must file with the Securities and Exchange Commission (under Rule X-13A-6) a current report on the occurrence of any of a number of events. Included in this list is "The execution of any voting trust agreement." This provision will bring to light voting trusts which otherwise would remain unreported until the next annual report of the registrant.

Mention should be made of the following provision contained in both the Securities Act and the Securities Exchange Act: "Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." [43] This provision may be of practical importance to voting trustees, because of their obvious ability to control the actions of the directors and managers of a corporation.

MEASURES TO PROTECT A TRUST FROM ATTACK

Coleman Burke, writing in the *Minnesota Law Review*,[44] suggests a number of provisions to be incorporated in trust agreements as a precaution against attack. His apparent in-

[43] Section 20(a) of the Securities Exchange Act. Section 15 of the Securities Act is worded differently, but has substantially the same meaning.

[44] "Voting Trusts Currently Observed," *Minnesota Law Review*, XXIV (1940), 374–76.

tent is to secure an agreement which will be acceptable to the Securities and Exchange Commission, as well as to most, or all, of the state statutes and courts. Several of his suggestions point toward grounds of attack which have not been used in the past, but which may be used in the future.

The precautionary measures are as follows:

(1) the agreement should state in full the purpose of the trust;
(2) the trust should be for a fixed period of time, not to exceed ten years, and it is safer to leave out provisions for renewal or, in any event, to permit dissenters to the extension to withdraw their stock;
(3) the agreement should recite valuable consideration besides mutual promises;
(4) a copy of the agreement should be open for inspection by the certificate holders;
(5) the duties of the trustees should be set forth at length;
(6) all stockholders of the same class should be permitted to join the trust;
(7) notice of the voting trust should be clearly marked on the stock certificates and transfer books;
(8) the trustees should have all rights of owners except the sale, mortgage, merger, or consolidation of the corporation without the consent of certificate holders;
(9) the trustees should be selected from the shareholders;
(10) no trustee should be permitted to be a director or officer of the corporation or its subsidiaries;
(11) any profit made by a trustee from the sale and purchase, or purchase and sale, of the corporation's securities within six months should be recoverable by the corporation; [45] and
(12) careful attention should be given to the insertion of provisions in the agreement regarding the manner of voting of the trustees, their right to vote by proxy, the filling of vacancies and the standard of care imposed upon the trustee.

[45] This is in keeping with the Securities and Exchange Act of 1934, Section 16(b).

— VIII —

THE CASE FOR AND AGAINST VOTING TRUSTS

THROUGHOUT THIS WORK the case for voting trusts has been treated as incidental to the purpose at hand. By way of summary and coördination we may here restate, briefly, the justifications for the voting trust as a device, (a) to shift corporate control, (b) to perpetuate an existing management, and (c) to secure the united action of the stockholders.

For the purpose of shifting corporate control, the advocates of the voting trust insist that the device is a useful or even indispensable instrument; without it, corporate reorganizations would, to say the least, be noticeably hampered. Management of a corporation can be taken from stockholders and allocated to the security-holding creditors, or bankers, in proportions commensurate with their investment in the corporation. It is said that it is only right that those who have the greatest financial interest at stake, or those who put new money into an enterprise of uncertain pecuniary merit, should acquire control in return for the investment or sacrifices which they are called upon to make. The stockholders of a corporation in need of reorganization have at best little remaining equity, so that their loss of control cannot be criticized as being contrary to justice.

Under circumstances not dissimilar to those existing in corporate reorganizations, the voting trust has proved itself to be an aid in raising new funds—funds which would not

otherwise be forthcoming, since the lender desires to protect his investment by means of a voice in the management of the corporation.

Again, the voting trust when initiated by the public authorities provides a means whereby corporate control can be distributed in any desired fashion. Socially desirable ends, such as the breaking up of combinations, are facilitated by the device. Powers which had rested with private individuals can be placed with the proper public officials so that specific public interests may be furthered.

The close corporation, it is contended, presents a somewhat different occasion for the voting trust. It enables the individuals owning a corporation to arrange control in proportions different from their respective investments. Thus, just as there may be silent and active partners in a partnership, the same result is facilitated for a corporation by the use of a voting trust. Likewise, there is no reason why a man should not be permitted to bequeath his corporate holdings to one person, while placing the control over the same property in the hands of a second person.

In general, advocates of the voting trust conclude that in the transfer of corporate control the device has so many legitimate uses that it is absurd to bring charges of anything unethical or contrary to public policy in the separation of stock ownership and voting rights.

One of the most important reasons offered for the perpetuation of a corporate control is the necessity for continuity of management and policy. This justification for the device is generally considered applicable to all voting trusts but especially to those originating with reorganizations and corporate promotions. Here a strong management is imperative either to aid in the resuscitation of the corporation or to give the new company a good start in life. Along with continuity of control is supposed to go efficient and responsible management, both of which are certainly worthy aims. On the other

hand, the voting trust keeps the corporation from falling under the domination of speculators who might surreptitiously gain control only to pillage the corporation for their own personal gain.

Who knows better than the corporate officials what the corporation needs? We are told that the stockholders can know little about the business problems of the modern enterprise; while the management, in dealing with the same problems day after day, acquires a specialized skill which cannot be matched even by the most enthusiastic amateur. In short, it is impossible to apply the "town meeting" principle to the corporate giants of today.

In this regard, one authority sums up the virtues of the voting trust in the following manner.

> The result of the normal voting trust has been to insure to a company both stability and continuity of policy, simple features which are often of substantial material advantage to the concern and to all its stockholders. It provides certainty of really responsible management. It makes impossible any disturbing attempts at interference by minority stockholders, which is a reasonable and practical consideration to be recognized frankly and at times properly. It concentrates on a small group the duty of putting a concern into satisfactory condition, giving them both the legal power and the moral obligation to make a real effort to that end. It makes it possible for those in control to formulate a well considered program for the conduct of the business with the assurance that they may remain unhampered until the wisdom, or futility, of their plans has been demonstrated. The substantial advantages which voting trusts have produced certainly outweigh the criticisms to which they have been subjected, and these advantages cannot be successfully ignored even by those who inveigh against the "disfranchisement" of American stockholders.[1]

Beyond its usefulness as a device to shift or perpetuate corporate control, the voting trust is also extolled as a method of attaining the united action of the stockholders. The tenor of the argument is to the effect that all stockholders should

[1] Cushing, *Voting Trusts*, p. 125.

band together in time of distress or emergency to protect themselves from a common danger. Thus it was seen that the shareholders of a number of small operating utilities during the nineteen twenties joined forces under a voting trust so that they might present a united front to any prospective purchaser of the corporation. Under somewhat different circumstance the stockholders of other companies have formed (or have been asked to join) a trust to insure their united action in fighting a depression, a war, or some other contingency detrimental to their interests. In some obscure manner a voting trust is supposed to aid the management in warding off bankruptcy, to solve problems resulting from the rising cost of raw materials, to keep war secrets from falling into enemy hands, and, in general, to tide the corporation over until better times. Then again, the several stockholders of a close corporation may unite under a voting trust in order to define and adjust their relative interests and at the same time protect themselves from one another.

These three needs which the trust fulfills—to shift control, to perpetuate an existing management, and to secure the united action of the stockholders—although overlapping, constitute the substance of the argument for voting trusts.

Turning to a consideration of the courts and the case for voting trusts, we find that legal writers, in addition to their efforts to develop the economic grounds for the voting trust, have attempted to rebut the argument of those courts which have held trusts to be invalid for technical reasons. Thus, as we have already seen, the voting trust is said not to be a proxy or an agency and hence revocable, but an outright conveyance of title to stock.[2] From the same sources we learn that consideration for the voting trust contract is found in the mutual promises of the parties bound by it and from the fact that the agreement is for the benefit of all the interested parties.

[2] See Wormster, *Columbia Law Review*, XVIII, 134–35; Miller, *Indiana Law Journal*, IV, 600–606; and Burke, *Minnesota Law Review*, XXIV, 354.

Since the courts have frequently objected to trusts on the ground of public policy and the disenfranchisement of the stockholder, this too has been a favorite topic of discussion. This theory that the separation of ownership and control is contrary to public policy is supposed to have arisen from the idea that each stockholder has a duty to his fellow stockholders.[3] Almost without exception, the legal writers ridicule the whole concept.[4] It is said that, owing to the size of the modern corporation, to the number of stockholders, and to proxy voting, control over the corporation has already slipped from the hands of the stockholders and the voting trust changes nothing. Robert Cutting writes that "The only tangible relationship existing between stockholders is one that imposes a duty on the majority not to oppress or defraud the minority. . . . To push the concept of a trust relationship beyond this point . . . savors of the fanciful."

In any event, we are told, public policy should be determined by the legislature and not by the courts. With respect to voting trusts, the proper policy has already been indicated by the passage of a number of statutes, and the courts are overreaching their power when they rule against the general trend.[5] Even if this were not the case "The persistency with which voting trust agreements have continued to remain a part of the legal apparatus of practicing attorneys bears eloquent testimony to the fact that they are useful devices and that the unfavorable reception that has been accorded to them by some courts is not justified." [6]

The prevailing opinion of most writers who concern themselves with the voting trust is that it is a useful instrument which, though capable of misuse, is far more likely to benefit

[3] Burke, *op. cit.*, p. 358.

[4] See Cushing, *Voting Trusts*, pp. 35–38; Burke, *op. cit.*, p. 358; Smith, *Columbia Law Review*, XXII, 636; Wormster, *op. cit.*, p. 134; Harriman, *Yale Law Journal*, XIII, 112; Cutting, *Albany Law Journal*, XLIV, 190; and Miller, *Indiana Law Journal*, IV, 604.

[5] See Finkelstein, *Michigan Law Review*, XXIV, 369.

[6] *Ibid.*, p. 368.

the security holders. Legal writers, in particular, tend to stress the advantages of the device to the exclusion of its evils because their purpose is to justify the existence of the voting trust. Thus, Coleman Burke writes that "It is the main purpose of this article to show why the voting trust device, though criticised and abused, should receive the approval of all our legislatures and courts." [7] Even before the turn of the century Jesse Lilienthal had the same purpose in mind when he wrote on public policy.[8] Likewise, Cushing carefully avoids any discussion of the misuse of voting trusts and only occasionally makes passing reference to such a possibility.

Nevertheless, probably all writers concede that along with the "good" goes the "bad." For example, one lawyer writes that "It is, of course, idle to say that trust agreements have never been used for any other than salutary purposes." [9] And again, "Of course, the trust device is not without its dangers. It does lend itself to improper manipulations of the company's property and places the interests of minority stockholders under some hazard. But the recognized uses of voting trusts would seem sufficiently to outweigh, in the balance of economic convenience, the resultant concentration of power in a few hands." [10] Arthur Dewing likewise concedes that the voting trust is capable of abuse, but adds that "Everything in this world of ours is subject to the dangers of abuse, from man's procreative powers to gooseberry tarts at Thanksgiving." [11] Other economists, although not always so enthusiastic about the device as Dewing, tend to believe that the voting trust does have legitimate uses. Commonly, however, they devote so little attention to the subject that their conclusions, if any, are unconvincing.[12]

[7] *Minnesota Law Review,* XXIV (1940), 348.
[8] *Harvard Law Review,* X (1996–97), 428–38.
[9] Finkelstein, *Michigan Law Review,* XXIV, 35.
[10] *Harvard Law Review,* XL (1926), 108.
[11] *Financial Policy of Corporations,* 1934, p. 397, footnote.
[12] Writers in the field of corporation finance seldom devote as much as two

Some writers have taken the view that the voting trust is inherently objectionable. Marion Smith writes that "It can hardly be argued that it is desirable to place the government of corporations in the hands of those not financially interested in the business results, who are to exercise an unrestrained discretion in the management of the companies, and who are not made subject to the approval of the stockholders for continuation in control." [13] William O. Douglas, in a speech before the Bond Club of New York, stated that the voting trust is "little more than a vehicle for corporate kidnapping" and that it provides promotors with a "convenient device for eating their cake and having it too." [14] Samuel Untermyer, on the other hand, was not quite so critical when he said that "No adequate reason for their existence has ever been offered except as an incident to the reorganization of insolvent corporations." [15] The House of Representatives report on Real Estate Bondholders Reorganizations took a most extreme view in that it pictured the voting trust as a device leading to

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or three pages to the voting trust, and sometimes even fail to mention it. Most commonly they describe the device and its uses, but refrain from commenting on its virtues or evils. For example, see Joseph Howard Bonneville, *Organizing and Financing Business*, revised edition, 1936; Calvin Crumbaker, *Organizing and Financing Modern Business*, 1939; Kenneth Field, *Corporation Finance*, 1938; and Milo Kimball, *Principles of Corporation Finance*, 1939. Edward S. Mead apparently favors voting trusts (*Corporation Finance*, 1939, p. 677), as does Hugh R Conyngton, who writes that "The voting trust plan is effective in maintaining a specified control and is sometimes very desirable" (*Financing an Enterprise*, 5th edition, 1921, p. 411) Henry E. Hoagland apparently felt that there was no need to question the motives behind the creation of any voting trust when he wrote that "Occasionally the administration of a voting trust is so satisfactory that it is continued even after its original purpose has been served. When the voting trust agreement of the Rio Grande Valley Gas Company expired in 1937, holders of both voting trust certificates and common stock, asked that the trust be continued for a period of ten years" (*Corporation Finance*, 2d ed., 1938, p. 36). Possibly the management did prove successful, but it was the same men who were in control in 1935 when the company was reorganized. Apparently Mr. Hoagland got his information from the stock prospectus issued in 1937.

[13] *Columbia Law Review*, XXII (1922), 636.

[14] New York *Times*, March 25, 1937, p. 37.

[15] "A Legislative Program to Restore Business Freedom and Confidence," an address delivered in 1914, privately printed, p. 24.

the acquisition of the property by the trustees "without the investment of a single dollar." [16]

In spite of these occasional denunciations of the voting trust, however, its supporters have been more than able to hold their own, with the result that the use of the device has spread from one field to another and that state statutes, presumably regulating them, have been relaxed concomitantly.

In the case against voting trusts, the weightiest single factor is minority control. That the voting trust does involve such control over a corporation, in the sense that the trustees seldom own more than a small fraction of the voting stock, is undeniable. Any discussion of it, however, must begin with the statement that there is nothing unusual about the separation of ownership and control, and that, on the contrary, our whole corporate system is geared to just such an end. Since the modern corporation, sometimes involving the investment of several billion dollars, necessitates the coöperation of numerous individual investors, all of them cannot have a hand in its management. Probably, only a few are capable of expressing an intelligent opinion at a stockholders' meeting; while of these, only a part will wish to concern themselves with the active management of the corporation. This situation is unavoidable, and will, no doubt, continue so long as the present industrial and political system itself endures.

Despite these facts, however, it does not follow that minority control should be facilitated and encouraged by the use of such a device as the voting trust. Some separation of ownership and control is a necessary evil of our system which must be tolerated in order to gain certain desirable ends, but to extend minority control needlessly is foolhardy. There is no need for any lengthy proof that the absolute separation of ownership and control through the voting trust is of questionable merit. We need ask only one question: would a private individual, not under pressure, turn over property to an at-

[16] Supplemental Report, 1936, p. 24.

torney for ten years without retaining the right to question the attorney's acts, without demanding bond and at the same time permit the attorney as an individual to trade with himself as trustee, liable not for mistakes of ignorance or neglect, but only for wilful misconduct? The answer is obvious. No sane man would sign such a contract involving physical property previously under his control if he had a chance to bargain, face to face, with his attorney. But, it is to be regretted, the same man, without any qualms whatsoever, may turn over his stock under just such a contract to an individual whom he has never seen and about whom he knows nothing. No doubt the individual in this case feels that he is losing nothing of value, for he probably did not exercise his voting power directly, anyway. But he forgets that at some future date he and his fellow security holders may desire to use their collective power to throw out the old management. And although this right may never be exercised, it remains to prod the old management to greater effort.

Factual control by a minority in interest of the stockholders of the modern corporation is admittedly unavoidable. But just as it would be foolish for an individual to strip himself of the right to direct the management of his own real property, so should he refrain in his corporate dealings from changing factual control by the minority into absolute and legal control. As a matter of principle, if for no other reason, the stockholder should not implement minority control.

Coleman Burke can see nothing wrong with this situation; for, he points out, a majority of the stockholders have agreed to it.[17] But, as a matter of fact, even assuming that a majority of the stockholders did consciously agree to this situation, have they any right to sign away the rights of the minority stockholders? What has happened is that a majority of the stockholders in accepting a situation which might involve minority control have, in effect, forced the minority stock-

[17] *Minnesota Law Review*, XXIV, 355. See also, Miller, *Indiana Law Journal*, IV, 600–606.

holders to join the agreement with them. Such a nonassenting stockholder is excluded from any voice in the management of the corporation for the duration of the trust. If he has a grievance against the management of the corporation he can not even appeal to the other stockholders for support, for a majority of them have already committed themselves to the trust agreement. It is small consolation to him that he may deposit his stock with the trustees, as this will not give him a voice in the control.[18]

Of course, if it can be assumed that the trustees actually represent all or substantially all of the stockholders of a corporation the question of minority control cannot be raised; but the key word of such a statement is the word "represent." Trustees are not agents, as their powers, once acquired, do not rest upon the continued confidence of the stockholder. We are even told that they are the legal owners of the stock voted by them. In a large corporation the trustees are neither selected nor elected by the certificate holders, but are either self-appointed or chosen by bankers or others to "represent" them. More realistically, then, the voting trust involves the separation of beneficial ownership and control whenever the trustees do not own a majority of the stock of a corporation, and any other interpretation of minority control is of questionable merit.

Advocates of the trust device take pains to point out that the voting trust, in concentrating power in the hands of a few men, simultaneously concentrates responsibility there and thus leads to efficient management.[19] These persons reason that a small body of trustees naturally is more anxious to act correctly than is a large board of directors wherein size alone tends to minimize the element of personal responsibility. Ad-

[18] Some writers appear to believe that a stockholder by depositing his stock with trustees gains a share in the control of the corporation. See Burke, *Minnesota Law Review*, XXIV, 357.

[19] See the *Harvard Law Review*, XL (1926), 108; Cushing, *Voting Trusts*, p. 24.

mittedly, this argument is appealing, but its test rests not on its apparent logic, but on the accomplishments of the voting trust in actual practice.

All things considered, the use of the voting trust during the nineteen twenties and thirties does not appear to add to the prestige of the device. The twenties saw the trust used in association with the promotion of holding companies of a most speculative character—companies which in many cases did not survive the ensuing depression. Of course, there is no particular reason to believe that voting trusts necessarily contributed to this end, but the mere fact that they were associated in so many cases with companies which had no social justification for existence does not speak well for them. If the calibre of the trustees actually did assure responsible management, this was in refreshing contrast to the conduct of the promotors who created the trusts and selected the trustees.

After 1930 the real estate trust developed. This was created and hence controlled by the same interests that only a few years earlier had sold bonds of questionable merit to a gullible public. The seriousness of the situation regarding real estate reorganizations and their resultant trusts was thought to justify investigations by three separate government agencies.[20]

The assumption that the trust device creates responsible management is contradicted by the means used to encourage stockholders to deposit their stock with trustees and by the potentially adverse interests of the trustees resulting from their conflicting security holdings. Further contradiction of the assumption is found in trust agreement clauses permitting trustees to trade with themselves without liability for the consequences of their acts so long as they avoid fraud.

Are trusts innocuous? Along with the argument that the voting trust is a necessary device to concentrate corporate control many writers have coupled the idea that in any event

[20] These investigations (cited above) were made by the Securities and Exchange Commission, the House of Representatives, and the New York State Legislature.

a trust changes nothing. We are told that the development of the large corporation together with proxy voting has, in effect, eliminated the voting right of the small stockholder anyway, so that he is just as effectively represented by voting trustees.[21] The difficulty with these two arguments for the voting trust when taken together is that they are contradictory. If the device does concentrate control it must do so by centering in the hands of a few men powers previously exercised by many. But in spite of this obvious fact, we are told that the stockholder has no actual rights to give up. The truth of the matter must be that the stockholder has some powers of which the trust relieves him, or no voting trust would ever be created. Promoters, corporate officials, and bankers would not go to the trouble of forming voting trusts if they did not change the existing situation or perpetuate it.

There is considerable truth in the belief that the stockholders have few exercisable rights, but the mere existence of their few remaining powers raises the question of whether or not they should slough off those too. Is not the factual control maintained by the usual corporate officials sufficiently strong, or even too strong, without the aid of a voting trust? That the management of most corporations remains fixed for long periods of time cannot well be doubted. Corporations can be organized and reorganized and still be managed by the same persons. Time and again voting trusts can be terminated or extended without any significant change in management of the corporation, as witness the Gorham Manufacturing Company, Columbian Carbon Company and even the small Cable Electric Products, Incorporated. Cushing writes that "Indeed, it is noteworthy that in few instances does it appear that such a trust has been created primarily for the purpose of maintaining control in the hands of those who might not otherwise be able, or entitled, to exercise it."[22] Although this may be one of the virtues of the voting trust it

[21] See Cushing, *Voting Trusts*, p. 38. [22] *Ibid.*, p. 22.

is at the same time an argument against it. If control will remain where it is put, why strengthen it still further with a voting trust?

Voting trusts are not innocuous. They take from the stockholder his last remnants of power—power which might act as a check on an otherwise unrestrained management. Usually, at least, there is sufficient continuity of management without a voting trust.

Another charge against the device is that of milking the corporation. Behind the protecting wall of the voting trust the trustees are in an exceedingly strong position to pilfer the corporation if they so choose. In good part they can avoid the liability of directors, if they desire, by appointing dummies in their stead, and then hide behind the immunity clauses of the trust agreement.[28] The trustees are usually empowered to fix their own salaries without outside interference, sell their own property to the corporation, or direct trade toward other companies in which they are interested. Even if there is no question about the honesty of individual trustees, it requires a man of considerable genius to place the proper value on his own services and property.

Unlike directors, trustees do not have to account for their actions before a stockholders' meeting each year; indeed, they do not even have to concern themselves about what the stockholders think of their actions, at least until the termination of the trust. The trustees need not even give a certificate holder the right to examine the list of his fellow certificate holders so that he may communicate with them. Usually the only way to oust a trustee before the termination of a trust is to prove in court that he has been guilty of fraud and thus should be removed. Mere suspicion is of no avail, for proof of wrongdoing is necessary. Although the certificate holder is generally believed to have most of the legal rights of a stockholder, except the right of voting, his legal position is still

[28] It is to be noted that the Securities and Securities Exchange acts, in effect, make the trustees liable for the acts of their agents.

not so clearly defined that it is possible to impede any action he may take to protect his interests.

The voting trust in itself is conducive to fraud, yet even the law, by sanctioning immunity clauses, has led to the same end. It is not enough to argue that trustees have seldom abused their powers, even if that is true. The evil lies in the existence of unnecessary powers which can, and will in some cases, be misused.

Should a stockholder deposit? If a stockholder has any choice in the matter, why should he choose to deposit his stock with trustees? Of course, at certain times and under peculiar circumstances such a course of action may be desirable. For example, it may be necessary in order to secure a market for the securities. But for the ordinary small stockholder there appears to be no convincing reason why he should deposit. Not even Henry P. Davidson, a partner of J. P. Morgan and Company, could think up any reason why a minority stockholder should join a voting trust.[24] Our hypothetical stockholder has no reason to believe that any given management is better than some other which might gain control over the corporation, for he has no personal knowledge of the men involved and no accurate way of determining the success of their policies. In fact, some might feel, in keeping with their political beliefs, that it is wise to change administrations now and then just as a matter of principle. Once again, it is well to repeat, the latent power of the stockholders to remove directors has a salutary effect on management even though it is never exercised.

Does the voting trust protect scattered stockholders? Undoubtedly it has proved beneficial to the interests of stockholders in many cases, but the implication of some writers [25] that the scattered stockholders join together on their own

[24] House of Representatives, *Money Trust Investigation.* Hearings pursuant to H. Res. 429 and 504, p. 1816.

[25] See, among others, Berry, *University of Cincinnati Law Review,* VI (1932), 78.

initiative to protect their interests is most questionable. It is the promoter, corporate management, or banker who forms the voting trust "for" the security holders and presumably for their protection. But as we have seen, the promotor of a voting trust seldom has any direct financial interest in the corporation and his concern for the welfare of the security holder must, at best, rest on his paternal instincts, his desire to keep a job, or his other proper interest in the emoluments of control. No doubt many voting trusts have been created with the interests of the security holder in mind, but it is well to stress the nature of their initiating force.

The trust agreement is not between equals. Like bond indentures, deposit agreements, and even the lease contract on a city apartment, the trust agreement is written by one party to the contract and his counsel and is either accepted or rejected, without change, by the second party. The stockholders do not bargain with one another, draw up a trust agreement and choose trustees; the conditions are imposed upon them. If this were not the case, the trust agreement would, no doubt, be a very different instrument, as the stockholders would then insist on the inclusion of provisions designed to protect them from the trustees as well as from the other contingencies for which the trust was created. It is highly probable that the average stockholder never sees a copy of the agreement to which he is asked to assent by depositing his stock; indeed, he would have difficulty obtaining one if he tried. But even if he does read the agreement, and can understand it without the aid of a lawyer, his efforts may have been in vain. If the voting trust is a part of a reorganization plan his only alternative to agreeing to the trust is to reject the whole plan—an act which may prove costly to himself and to all the other security holders. But even assuming that the trust arises under circumstances which give the stockholder greater freedom of choice, he still may feel compelled to assent because of the various forms of pressure which may be

brought to bear upon him. To repeat: the trust agreement is not between equals and is not the result of a bargain, but is a unilateral contract in which the stockholder signs away most of his rights in return for the trustees' obligation to exercise some judgment in the handling of the trust property.

Are voting trusts necessary? As we have already seen, the voting trust can prove to be a very useful instrument in a voluntary reorganization; control over the corporation can be taken from the stockholders, given to the creditors who have the greatest financial interest in the property, and receivership thus avoided. Undoubtedly, a strong case for a voting trust can be built up when it is used in this way. On the other hand, the involuntary reorganization presents a different problem. There is no impelling reason for transferring control from one group of security holders to another, as the capital structure can be arranged in any desired manner. Voting trusts used in this fashion should be viewed with some question.

The close corporation may have need of the trust device in several legitimate ways; to redistribute control among the several "partners," or in connection with the settlement of an estate. Obviously, there is no reason why a man should not bequeath his property to one person and the control of that property to another; nor should anyone normally object to a contract resulting from a bargain between equals.

A great majority of the voting trusts, however, including most of those resulting from involuntary reorganizations, must be justified by the need for fixity of control, and not by the necessity for shifting corporate control. This is particularly true of "promotional" trusts which must rest their case on the demand for strong aggressive management and continuity of policy. But, as we have seen, the usual corporate officials are so entrenched in their position that to strengthen their hold is ordinarily unwise. Even the possibility that management may change now and then is certainly less re-

grettable than the possibility that an incompetent management may maintain its position because of a voting trust.

Little proof has been offered in this or the preceding chapters to show that the voting trust has been "excessively" abused, nor is such proof necessary to the conclusion that the use of the device is generally undesirable. What has been shown is that the trust device is capable of misuse and has been so misused in a number of individual cases, and that it has few counterbalancing advantages. If the advantages of a particular voting trust do not outweigh the obvious defects of the device, it has no right to exist. Coleman Burke was in part right when he said that the case of the opponents of the voting trust rested on the possibility of abuse,[26] but it is equally true that the case of the advocates is based upon the unproved necessity for its use.

THE REGULATION OF VOTING TRUSTS

There is no doubt, in this writer's mind, but that the trust device should be subjected to additional Federal and state regulation; the only remaining question involves the specific measures to be taken. Fortunately, so far as Federal supervision is concerned, the machinery for such regulation is already in existence in the form of the Securities and Exchange Commission. Already, under the Chandler Bankruptcy Act of 1938, the commission is given the right to advise the Federal courts on the fairness or feasibility of a plan or plans of reorganization of a company whose debts exceed three million dollars and as a consequence pass upon the merits of any proposed voting trust,[27] but this is not enough. In the first

[26] *Minnesota Law Review*, XXIV, 348.

[27] The pertinent sections of the Bankruptcy Law, approved June 23, 1938, are as follows:

Section 172. After the hearing [on the several reorganization plans which may be offered] . . . and before the approval of any plan, . . . the judge may, if the scheduled indebtedness of the debtor does not exceed $3,000,000, and shall, if such indebtedness exceeds $3,000,000, submit to the Securities and Exchange Commission for examination and report the plan or plans

place, the law relates only to voting trusts resulting from corporate reorganizations; while in the second pleace, the Securities and Exchange Commission has only advisory powers and thus may be overruled by the court. So far as this second point is concerned, however, the difference between advisory and absolute power over a reorganization plan may be small indeed. The right of the commission to criticize a proposed voting trust and to have this opinion transmitted to the security holders, whose assent to the plan is necessary to secure its acceptance, should do much to discourage the unnecessary use of the device.

Up to the present time the commission has issued "releases" on only two companies in which the trust device was proposed, but from these it is apparent that the commission does not favor the device. In the "Matter of the San Francisco Bay

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which the judge regards as worthy of consideration. Such report shall be advisory only.

Section 173. The judge shall not enter an order approving a plan submitted to the Securities and Exchange Commission until after the Securities and Exchange Commission has filed its report thereon or has notified the judge that it will not file such a report, or until the expiration of such reasonable time for the filing of such report as the judge has fixed, whichever first occurs.

Section 175. Upon the approval of a plan by the judge, the trustee or the debtor in possession shall transmit, by mail or otherwise, to all creditors and stockholders who are affected by any such plan—

(1) the plan or plans so approved, together with a summary thereof approved by the judge;

(2) the opinion of the judge, if any, approving the plan, or plans, or a summary thereof approved by the judge;

(3) the report, if any, filed in the proceedings by the Securities and Exchange Commission, . . . or a summary thereof prepared by the Securities and Exchange Commission; and

(4) such other matters as the judge may deem necessary or desirable for the information of creditors and stockholders.

Section 208. The Securities and Exchange Commission shall, if requested by the judge, and may, upon its own motion if approved by the judge, file a notice of its appearance in the proceeding under this chapter. Upon the filing of such a notice, the Commission shall be deemed to be a party in interest, with the right to be heard on all matters arising in such proceeding. [For an extended examination of the whole law, see Jacob I. Weinstein, *The Bankruptcy Law of 1938*.]

Toll Bridge Company" [28] it is reported that the stock of the proposed company is to be deposited with the trustee for the new bonds, to be voted by it *as directed* by the new bondholders. The purpose of the trust is to place control with the initial bondholders even in the event that they sell their stock. Although the commission has no great objection to such a trust, it does feel that a less cumbersome method of accomplishing the same end would be to attach the stock to the bonds. But if the voting trust is to be used, the commission continues, "provisions should be included assuring the bondholders of notice adequate to enable them effectively to exercise their rights to instruct the trustee regarding matters on which the stock is to be voted." [29] The whole reorganization plan of the Penn Timber Company, on the other hand, is objectionable according to the commission. The stockholders and junior creditors are permitted to participate even though the value of the property is not sufficient to cover the first mortgage bonds. Hence, the commission concludes, "If our views with respect to the unfairness of the present plan and the need for eliminating the junior interests are followed, we question the necessity for any voting trust agreement. Moreover, we question the adequacy of the representation of bondholders in the management through the device of having the Detroit Trust Company the sole person to nominate such representatives [i. e., the voting trustees]." [30]

It is to be hoped that the Securities and Exchange Commission will continue to discourage the use of the voting trust in so far as it is now able, but in addition, it might be wise to amend the Chandler Act so as to give the commission absolute veto power over the reorganization plans of large companies. If this were done, standards for the use of the voting trust in reorganizations could then be set up.

[28] Corporate Reorganization Release No. 32, July 25, 1940; and Release No. 21, April 2, 1940.

[29] Corporate Reorganization Release No. 21, p. 5.

[30] Corporate Reorganization Release No. 8, March 17, 1939.

The most objectionable voting trusts, however, remain unregulated by Federal law. In order to supervise trusts not resulting from reorganizations it would seem feasible for the Securities and Exchange Commission to be given the power to restrict or prohibit those trusts which must now be registered under either the Securities Act of 1933 or the Securities and Exchange Act of 1934. In addition, the commission should have the same rights and powers over the trusts of companies which must register securities other than voting trust certificates under either act. Thus it is proposed to regulate the trust of any company which desires to register any securities under either of the acts. In exercising the powers conferred by the Chandler Act and those here proposed, the commission might find it wise (1) to prohibit the use of the voting trust by new companies when the need is not obvious; (2) to prohibit any voting trust whose sole purpose is to strengthen an existing corporate control if there are no extenuating circumstances; (3) to require that the trustees vote the stock held by them as directed by the security holders for whose protection the trust is created, whenever this is possible (as in the case of a reorganization); (4) to prohibit the inclusion in the trust agreement of immunity clauses designed to protect the trustees from liability for negligence or ignorance,[31] and clauses permitting trustees to trade with themselves as individuals; (5) to require that the "interested" security holders be given the right to terminate the trust by a majority vote, machinery being created to take such a vote, possibly at regular referendums; (6) to demand that the interested security holders, whether their holdings are certificates or bonds, be permitted to examine the list of their fellow security holders; [32] (7) to place some restrictions on trustees also acting

[31] Under the Trust Indenture Act of 1939 (an amendment to the Securities Act of 1933) trust indentures must be registered with the commission, and in order to qualify they must not relieve the trustee of liability for its "own negligent action, or its own negligent failure to act, or its own wilful misconduct." Section 315 (d).

[32] If the corporation has no official list of its bondholders, it should be required to furnish whatever information it has.

as directors and officers; (8) to require trustees to make public the amount of their compensation; (9) to prescribe that trustees return to the corporation any profit they may derive from the purchase and sale or sale and purchase of securities within six months and any profit derived from the sale of a trusteeship; and (10) to require that on the termination of a trust the stock should be returned to the certificate holders as soon as possible.

No doubt other suggestions might be made besides those enumerated above, but they should be sufficient to attain the end of protecting the security holders and eliminating unnecessary trusts. Although it is likely that fewer trusts would be created under these conditions, the decrease should not be deplored.

There now remains the problem of those trusts which do not fall under Federal jurisdiction. In those states which have already created commissions similar to the Securities and Exchange Commission all that need be done is to follow the example set by the Federal government. But for the other states which neither have nor are willing to establish such a commission a few additional suggestions are appropriate.

To eradicate the worst features of the voting trust the states should at least amend their statutes so as to prohibit trusts of greater than ten years' duration and to restrict the use of immunity clauses, rather than to encourage them as at present. Trustees should become true trustees, with duties and liabilities as well as rights and powers. Similarly, those states which have not already done so, should require that the trust agreement be open for inspection, and that the security holders have access to the list of their fellow investors. The state courts should be required to pass upon the contents of trust agreements, the choice of the trustees, the compensation of the trustees, and where possible, demand that the bondholders or other security holders be given the right to instruct the trustee. Possibly a statute similar to the present New York real property law, but applicable to all

reorganizations, would fill the requirements.[38] If the senior security holders do not acquire the voting rights lost by the certificate holders, then court supervision over the trustees should be continued for the duration of the trust.

[38] See p. 150, *supra*.

APPENDIX I

Published
5/17/35

File No.________

Form 16

For Voting Trust Certificates and Underlying Securities

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.

Application for Registration pursuant to Section 12 (b) and (c) of the Securities Exchange Act of 1934 of:

I. Voting Trust Certificates

Issued by ________________________

____

(Names of all Voting Trustees)

II. Underlying Securities

Issued by ________________________

(Name of Issuer of the Underlying Securities)

Securities for Registration of Which Application Is Made	Amount to be Registered	Amount to be Registered upon Notice of Issuance	Names of Exchanges on which Registration Applied for
(Title of Voting Trust Certificates)			
(Title of Underlying Securities)			

Name and Address of Persons Authorized to Receive Notices and Communications from the Securities and Exchange Commission:

____

(For the Voting Trustees)

____

(For the Issuer of the Underlying Securities)

PART I

The information required to be given under the items hereinbelow set forth is more specifically defined in the "Instruction Book for Form 16 for Voting Trust Certificates and Underlying Securities."

The Instruction Book also sets forth requirements as to *Exhibits* which are to accompany this application or to be incorporated herein by reference.

Organization

1. Date, and date of expiration, of the voting trust agreement.
2. Name and address of depositary and address of office, if any, of voting trustees.
3. Name the exchange or exchanges upon which voting trust certificates are already registered.
4. Name the exchange or exchanges on which voting trust certificates are to be registered by other applications.
5. State the name of the issuer of the underlying securities (hereinafter called "The Corporation"), and the title of such securities.
6. Give the ratio, in percentage, of securities held subject to the voting trust agreement to the outstanding securities of the same class.
7. Outline briefly the principal provisions, if any, of the voting trust agreement restricting the deposit of additional securities.
8. Outline briefly the principal provisions of any agreement by which "The Corporation" has agreed to deposit securities under the voting trust agreement.

Designation of the Voting Trustees

9. Outline briefly the principal provisions of the voting trust agreement concerning:

(a) The designation of voting trustees, and of additional and successor voting trustees.

(b) The removal and resignation of voting trustees.

10. State whether the voting trust agreement requires action by the voting trustees to be taken by concurrence of the majority, and, if not, outline briefly the requirement.

The Voting Trustees

11. State the name and address of each of the voting trustees.

Name	*Address*

12. Describe briefly the business experience of each of the voting trustees for the last five years.

13. Indicate below any business, vocation, or employment of a substantial nature, other than with "The Corporation," in which each voting trustee is engaged for his own account or as director, officer, employee, partner, or trustee.

Name of Voting Trustee	Position	Other positions held Name and principal business of company or firm

14. Describe briefly any substantial business or professional connection which any voting trustee has had, within three years, with: (a) "The Corporation," or any of its parents, subsidiaries or predecessors; (b) any principal underwriter of the voting trust certificates or of any securities of "The Corporation" issued within three years.

15. Give the following information as to the voting trust certificates, the securities of "The Corporation" not deposited under the voting trust agreement, and the securities of its parents and subsidiaries owned of record or beneficially by each voting trustee and each person named in answer to Item 25.

Name of Owner	Voting Trust Certificates owned as of ________		Other Securities owned as of ________		
	Of Record	Beneficially	Title of Issue	Of Record	Beneficially

16. If any voting trustee represents, in regard to the affairs of "The Corporation," a person owning of record or beneficially any

voting trust certificates, or any securities of "The Corporation" or its parents and subsidiaries, give the following information as to such owner.

Name of Voting Trustee	Name and address of such owners	Nature of representation	Securities owned as of______			
			Name of Issuer	Title of Issue	Amount of Record	Amount Beneficially

17. Give the information required below in tabular form concerning the aggregate remuneration received during "The Corporation's" past fiscal year, directly or indirectly, by each voting trustee: (a) for acting as voting trustee; (b) from "The Corporation" and its subsidiaries in all of his capacities.

Name of Voting Trustee	Capacities in which Remuneration Received	By Whom Paid	Aggregate Amount of Remuneration

18. Give the dates of, parties to, and general effect briefly and concisely stated of every material contract now in effect between "The Corporation" and each voting trustee, or any person or persons represented, in regard to the affairs of "The Corporation," by any voting trustee.

Powers of the Voting Trustees

19. Outline briefly the principal provisions, if any, of the voting trust agreement limiting the powers of the voting trustees to vote the underlying securities for each of the following purposes. If the voting trust agreement does not restrict such powers, make a specific statement to that effect.
    (a) For directors of "The Corporation."
    (b) For any change in the capital structure of "The Corporation."
    (c) For amendment of the charter of "The Corporation."
    (d) For the sale, lease, or mortgage of assets of "The Corporation."
    (e) For the merger or consolidation of "The Corporation."
    (f) For the dissolution of "The Corporation."
20. Outline briefly the principal provisions, if any, of the voting trust agreement limiting the powers of the voting trustees to deal with securities and property held subject to the voting

trust agreement in each of the following respects. If the voting trust agreement does not restrict such powers, make a specific statement to that effect.

(a) Depositing the securities under a reorganization plan.
(b) Exchanging the securities for other securities.
(c) Exchanging the securities for cash or property.
(d) Holding or distributing any cash, securities, or property received by the voting trustees as dividends upon the underlying securities, or upon merger, consolidation, or dissolution of "The Corporation."

21. Outline briefly the principal provisions of the voting trust agreement empowering the voting trustees to:
    (a) Extend the voting trust agreement.
    (b) Terminate the voting trust agreement.
    (c) Amend the voting trust agreement.

Compensation and Limitation of Liability of the Voting Trustees

22. Outline briefly the principal provisions of the voting trust agreement concerning:
    (a) The compensation of the voting trustees and by whom paid. Indicate whether the amount of such compensation is to be determined by an independent person.
    (b) The powers of voting trustees in each of the following respects. If the voting trust agreement grants voting trustees unrestricted powers in these respects, make a specific statement to that effect.
        (1) Dealing or trading in voting trust certificates or securities of "The Corporation."
        (2) Contracting with "The Corporation."
    (c) The limitation of liability of the voting trustees.

The Holders of the Voting Trust Certificates

23. Does the voting trust agreement empower the certificate holders to withdraw the underlying securities prior to the termination of the voting trust agreement? If so, outline briefly the principal provisions.
24. Outline briefly the principal provisions of the voting trust agreement, or any other agreement between the voting trustees, the certificate holders, the depositary, and "The Corporation," or any of them, concerning:

(a) Action by the certificate holders, other than any provisions outlined in the answers to Items 8, 19, 20, 21 and 23.

(b) The rights of certificate holders to inspect the transfer books and list of certificate holders.

(c) The publication to certificate holders of reports with respect to the business and financial condition of "The Corporation."

25. Give the information required below for all persons owning of record more than ten percent of the voting trust certificates.

Name and Address *Amount Owned* *Percent Owned*

Part I of this application comprises:

(1) The application proper, containing pages numbered _____ to _____ consecutive and insert pages numbered __________

(2) The following exhibits

This application is filed subject to the instructions contained in The Instruction Book for Form 16 for voting trust certificates, as published under date of ______ and as amended under date(s) of ____________

Upon the basis of the statements and documents comprising Part I of this application the undersigned hereby apply for registration pursuant to Section 12(b) and (c) of the Securities Exchange Act of 1934 of the voting trust certificates specified on the facing sheet of this application on the respective exchanges there specified.

SIGNATURES OF ALL VOTING TRUSTEES

____

____

Date

PART II

(Part II need not be filed if the securities held subject to the voting trust agreement are otherwise permanently registered upon the exchange upon which registration of the voting trust certificates is sought.)

Submit information as to the issuer of the underlying securities as required by the Form and Instruction Book appropriate for permanent registration of securities of such issuer. This Part II

shall be deemed to incorporate in all respects the respective requirements of such appropriate Form and Instruction Book, except that the facing sheet of such appropriate Form shall not be submitted.

Matters contained in Part I or in any application for the permanent registration of securities of "The Corporation" on the exchange upon which registration of the underlying securities is sought, may be incorporated by reference as answer or partial answer to any item in this Part II, provided the reference is specific and the matter incorporated is clearly designated in the reference.

APPENDIX II

Registration No. ____________

Form F-1

FEDERAL TRADE COMMISSION
SECURITIES DIVISION
WASHINGTON, D.C.

REGISTRATION STATEMENT

Voting Trust Certificates

Name of issuer (if issuer has no name, give names of trustees):
Address of issuer:
Name of issuer of securities to be held subject to the trust agreement:
Type and amount of securities to be represented by the certificates registered hereunder:
Amount of filing fee: [1]
Date of proposed offering or delivery of voting trust certificates:
Name and address of person who is authorized to receive service and notices which may be issued by the Federal Trade Commission:

Definitions of Words Used in Form F-1 [2]

As used in this form, unless the context clearly indicates otherwise:

1. The term "foreign or territorial person," as applied to a trust, means a trust of which the majority of the trustees or persons per-

[1] See instruction 10, p. 2, of the rules and instructions accompanying Form F-1, and table on p. 2 of this form.

[2] See instruction 10, p. 3, of the rules and instructions accompanying Form F-1.

forming similar functions are residents of a foreign country or of a territory.

2. The term "The Corporation" means the issuer of the securities held or to be held subject to the trust agreement, whether the issuer of such securities be a corporation, trust, or other organization.

3. The terms "voting trust certificate," "sale," and "issuer" have the meanings given in paragraph 4 of the rules as to the use of form F-1 (printed in the rules and instructions accompanying form F-1).

4. The term "predecessor" means:

(1) The issuer, other than "The Corporation," of any outstanding securities which have been acquired within 6 months or which have been acquired or are to be acquired pursuant to a plan of reorganization, directly or indirectly by "The Corporation," where ownership of such securities gives or will give control of such issuer; or

(2) The last or present owner of any interest in property which has been acquired within 6 months or which has been or is to be acquired pursuant to a plan of reorganization, directly or indirectly by "The Corporation," and which comprised or comprises substantially all the assets used in the operation of a particular business of such owner or at least all such assets other than (a) any current assets and/or (b) investments as distinguished from operating assets, and each other person who was such an owner for a period of not less than 6 months within 3 years prior to the date of filing of the registration statement;

Provided, however, that the term does not include any statutory or judicial receiver or trustee, mortgage trustee, security holders' committee or member thereof, reorganization or readjustment manager, or nominee thereof, voting trust or voting trustee, or any person performing functions similar thereto.

Provided further, however, that the term is confined to a period of 3 years immediately preceding the filing of the registration statement, and, in case the predecessor is within (2) above, is further confined to the period, during such 3 years, of the ownership, by the predecessor, of the interest referred to.

Calculation of Fee [3]

(To be filled out whether or not the minimum fee is payable)

Securities represented or to be represented by voting trust certificates registered hereunder

Number and class of shares or other securities ________________

Market value per share or unit	Date of Market Value	If no market value; face, par, or stated value per share or unit	Aggregate market or other value

One one hundredth of 1 percent of the above aggregate value

Information to Be Contained in the Registration Statement

1. Name of the issuer (if it has a name) and its address.
2. Name, address, and principal occupation of each of the persons now acting and of each of the persons designated to act as voting trustees,[4] indicating as to the latter whether or not their consent to act as such has been obtained.
3. If the issuer be a foreign or territorial person,[5] name and address of its duly authorized representative in the United States.
4. Name of the issuer of the securities held or to be held subject to the trust agreement ("The Corporation" [6]).
5. Office addresses of "The Corporation."
   (a) Statutory office.
   (b) Principal business or executive office.
6. Name of the State or other sovereign power, and a reference to the statute thereof, under which "The Corporation" is incorporated or organized.
7. The following information with respect to the securities held or proposed to be held subject to the trust agreement:

[3] See instruction 10, p. 3, of the rules and instructions accompanying form F-1.

[4] As used throughout this form, except where the context clearly indicates otherwise, the terms "voting trustees" and "trustees" include every person named in answer to this item.

[5] See definition 1, p. 2.

[6] See definition 2, p. 2.

Number and class of shares or other securities authorized to be held	Face, par, or stated value per share or unit	Number of shares or other securities represented by certificates registered hereunder

8. State which, if any, of the following relationships with reference to "The Corporation" or any of its predecessors is occupied, or was occupied within 2 years prior to the filing of the registration statement:
   (a) By any of the voting trustees:
   (1) Officer; (2) director; (3) trustee; (4) partner; (5) counsel (such relationship being based upon a general retainer, or a regular course of practice); (6) creditor, whose claim (not represented by a security) exceeds, or at any time during the period of such relationship exceeded, $50,000; (7) beneficial owner, directly or indirectly, of securities carrying more than 25 per cent of the voting power; (8) purchaser or seller of goods or services in a regular course of dealing;
   (b) By any corporation, association, trust, or partnership, of which any voting trustee is or was (at the time of the relationship) an officer, director, trustee, partner, or controlling security-holder.
   The relationships stated above under (a) (5) to 8 inclusive;
   (c) By any officer, director, trustee, or partner, of any such corporation, association, trust, or partnership:
   All relationships stated above under (a).
   For the purposes of this item, any person controlling a voting trustee is to be treated as a voting trustee.
9. If any of the trustees have been designated as trustees to represent security-holders other than the holders of the certificates of the trust, state briefly what security-holders or class of security-holders they represent or are to represent.
10. State, with respect to each trustee, any position (other than that of voting trustee) held or proposed to be held in "The Corporation."
11. State the number or amount of the securities subject or to be subject to the trust agreement in which each trustee now has or proposes to acquire a beneficial interest.

12. State the number or amount and the class or title of those securities of "The Corporation" neither now subject nor to be subject to the trust agreement in which each trustee now has or proposes to acquire an interest, indicating the nature and extent of the interest.
13. State the maximum period of duration of the agreement under which the certificates registered hereunder are proposed to be issued.
14. Summarize briefly the principal provisions of the agreement, if any, with respect to the earlier termination of the agreement, stating whether or not the holders of certificates have any power of termination.
15. Summarize briefly the principal provisions of the agreement, if any, for the removal of trustees, stating whether or not the holders of certificates have any powers of removal.
16. Summarize briefly the principal provisions of the agreement, if any, with respect to the designation of additional and successor trustees.
17. Summarize briefly the principal provisions of the agreement, if any, limiting the liability of the trustees.
18. State whether or not provision is made in the agreement for a depositary to hold the securities for the trustees, and, if so, give the name of such depositary and summarize briefly the principal provisions, if any, limiting the liability of such depositary.
19. State whether or not the agreement places any limitations upon the power of the trustees to vote the securities held by them, and, if so, briefly summarize such limitations.
20. Summarize briefly the principal provisions of the agreement, if any, with respect to powers of the trustees to deal with the securities held in trust in ways other than the voting thereof.
21. State whether action by the trustees in voting or otherwise dealing with the securities held is to be taken by majority vote, and, if not, state the vote required.
22. State whether or not the agreement places any limitations upon the power of the trustees to deal or trade in the certificates registered hereunder or in securities of "The Corporation," and, if so, summarize briefly such limitations.
23. Summarize briefly the principal provisions of the agreement, if any, with respect to compensation of the trustees and any depositary and the funds out of which such compensation is to be paid. If no provision is made for the determination of the amount thereof by an independent person, make a specific statement to that effect.

24. Summarize briefly the principal provisions of the agreement, with respect to the distribution of any dividends, interest, etc., among the holders of certificates.
25. State whether or not any bond is posted or proposed to be posted by the trustees with respect to their performance of the agreement, and, if so, the amount thereof.
26. Give the names and addresses of counsel acting for the issuer in connection with the issuance of the certificates.
27. With respect to each denial by a governmental regulatory body affecting the right to sell securities issued by the issuer, explain briefly the grounds of the denial.

Exhibits

The following exhibits shall be attached as a part of the registration statement. The issuer may file such other exhibits as it may desire, marking them so as to indicate clearly the item to which they refer. If any of these exhibits are not submitted, state why this requirement cannot be met.

Exhibit A. Copy of trust agreement.

Exhibit B. Copy (specimen, if available) of the form of voting trust certificates registered hereunder.

Exhibit C. Certified copies of orders of all governmental regulatory bodies by which any securities of the trust were or are denied the right to be sold (see item 27) and of any subsequent orders of such bodies with respect to such denials.

Exhibit D. Copy of prospectus.

SIGNATURES

Issuer (trust) [7] ____________________

By ____________________
(Name) (Title)

If the signature on behalf of the issuer is signed otherwise than by all of the trustees,[8] attach evidence of the authority of the person or persons by whom it is signed.

All Trustees:

[7] The signature or signatures here should be such as will bind any assets of the trust, but will not, if the trust agreement so provides, bind individually the persons signing. In every case the statement must be signed both by or on behalf of the trust and (below) by all the trustees.

[8] As used here, "trustees" means only such persons as are, at the time the registration statement becomes effective, parties to the trust agreement as trustees.

If, in addition to the group of persons who sign immediately above, the governing instruments provide for other's whose functions are similar to those of directors of a corporation, a majority of such latter persons must also sign. If such instruments provide for persons whose functions correspond to those of the principal executive, financial, and accounting officers of a corporation, their signatures also must be affixed. If the issuer is a foreign or territorial person (as defined on page 2 of this form), the signature of its duly authorized representative in the United States also must be affixed.

APPENDIX III

COMPARISON OF EARNINGS OF FIRMS WITH AND FIRMS WITHOUT VOTING TRUSTS

In order to reach at least a tentative conclusion on the financial success of voting trusts, the earnings and capitalization of one hundred and thirty-four real estate corporations have been examined; sixty-seven of these firms had trusts and an equal number did not. All of these corporations were reorganized between 1930 and 1938; and all were operating companies owning mainly apartments, hotels, theaters, and similar property.[1] In respect to these firms the following data are of interest:

	Location			
	Chicago	New York City	Elsewhere	Mean Capital
With trusts	11	12	44	$2,700,000
Without trusts	16	15	36	$2,400,000
	27	27	80	
Total 134				

In order to compare these corporations, the earnings of each for two years (in almost all cases) were divided by twice the average assets to secure the percentage return. The last two available financial statements were used in every case (usually those of 1937 and 1938). Earnings were defined in the first of two samples as gross

[1]

	Companies with voting trusts	Companies without voting trusts
Office buildings and stores	22	22
Hotels	20	20
Apartments	16	9
Theaters, garages, warehouses, and companies owning several types of property	9	16
Totals	67	67

profits less operating costs, less depreciation; and where depreciation was obviously not included in the statements, it was uniformly calculated at two percent of capital. Capital was taken to mean the balance sheet total of assets, unless this figure was greatly inflated by the inclusion of intangibles. In the second sample depreciation was not calculated even if obviously omitted from costs, and capital was taken as the balance sheet total without correction. These two samples, however, did not show any substantial difference in result, so the distinction may be ignored. It is to be noted that bond interest was not subtracted from earnings; thus earnings related to total capital, and therefore were not, except in a few cases, applicable to dividends.

After securing the percentage return for each company,[2] adding together those relating to firms with voting trusts, and dividing by sixty-seven, it was found that the mean average return on capital was .00873, or less than one percent; while the equivalent figure for firms without voting trusts was .01215. Thus the return on capital for those corporations with trusts was only 71.9 percent as

[2] Frequency Distribution of the Percentage Returns on Capital for the Companies Examined

Return to nearest percent	Number of Companies With trusts	Number of Companies Without trusts
.10	1	..
.09	..	..
.08	1	..
.07	2	..
.06	5	..
.05	3	6
.04	7	6
.03	5	8
.02	9	11
.01	8	9
.00	11	9
—.01	7	9
—.02	3	2
—.03	2	3
—.04	..	..
—.05	..	2
—.06	1	1
—.12	1	1
—.13	..	..
—.14	1	..
Totals	67	67

great as those without. In neither case, however, was the return large enough, on the whole, to pay bond interest; while for only a few individual companies was there anything available for dividends.

If certain assumptions are made, it is evident that those companies fared best which had no voting trust, and that the difference was significant to the security holders. But before finally accepting this conclusion several pertinent questions must be disposed of. It might be claimed that corporations with trusts tend to be more overcapitalized than those without, that the result was due to pure chance, that companies without trusts are located in more prosperous areas, or that the figures were not impartially gathered. Obviously, there is the possibility that chance alone was responsible for the difference (as we shall see in a moment), but as to the other arguments there is some rebuttal. An effort was made to eliminate nontrust corporations whose securities were owned by other companies and not directly held by the public. Had this not been done, it might easily have been claimed that companies of this type tend to be more conservatively capitalized, and that this has some effect on the results. But with these companies eliminated, it is difficult to understand why a voting trust, or the lack of one, should influence the capitalization. In the third place, it has already been noted that there is no significant difference in the location of the two classes of companies so far as New York City and Chicago are concerned, and those located "elsewhere" are scattered in cities all over the United States. And to preclude the possibility of inherent bias in the selection of both data and companies, they were taken, in order, from Moody's 1939 real estate manual. If the data was available for a company, and if it was not excluded for some other obvious reason, it was included. Since more firms had voting trusts than not, some of this group were excluded by an impartial method until the requisite number was obtained, but presumably *all* acceptable companies *without* trusts were included. If we bear these facts in mind, it is evident that the security holders of these *particular* companies did not gain, but actually suffered, from the use of the voting trust.

Assuming that the two groups of sixty-seven corporations each are merely samples drawn at random from infinitely large populations (an assumption which is not wholly justified) it is possible to examine our results statistically. By squaring the deviation of each percentage return from its respective group mean and totaling

the two columns of deviations from the mean squared, the following figures can be derived:

With trusts	Without trusts
$\text{Sigma}_1^2 = .00872$	$\text{Sigma}_2^2 = .001435$
$\text{Mean}_1 = .00873$	$\text{Mean}_2 = .01215$

$$\text{Sigma}_D = \sqrt{\frac{\sigma_1^2}{N_1 - 1}\,\frac{\sigma_2^2}{N_2 - 1}} = \sqrt{\frac{.000872}{66}\,\frac{.001435}{66}} = \sqrt{.00003495}$$

$$\text{Sigma}_D = .005912 \quad T = \frac{\text{Mean}_2 - \text{Mean}_1}{\text{Sigma}_D} = \frac{.01215 - .00873}{.005912}$$

$$T = .578$$

"T" makes it possible to determine whether or not the difference between mean_1 and mean_2 is significant, i. e., assuming the two groups of data have normal distributions, that they are samples from infinite populations, and that the cases were chosen at random. Thus we find that there are about fifty-six chances out of one hundred that a difference between the means could be as great as the one secured above and still be due to chance. In other words, there is about a sixty-forty chance that the two means are in reality identical. Therefore, it must be admitted that, in so far as we are studying samples, the result is not conclusive.

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The dates in parentheses following the name of a company indicate the duration of its voting trust